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Қаржы нарығын реттеу
және дамыту агенттігі

The Agency of the Republic of Kazakhstan
for Regulation and Development
of Financial Market

SREP
Supervisory Report

2024

Department of Bank Regulation

Almaty, 2025

CONTENTS

LIST OF ABBREVIATIONS AND ACRONYMS

Agency	Agency of the Republic of Kazakhstan for Regulation and Development of the Financial Market
BCBS	Basel Committee on Banking Supervision
Rules #188	Resolution of the Board of the National Bank of the Republic of Kazakhstan No. 188 of November 12, 2019 "On approval of the Rules for the formation of a risk management and internal control system for second-tier banks, branches of banks - non-residents of the Republic of Kazakhstan"
Rules #170	Resolution of the Board of the National Bank of the Republic of Kazakhstan No. 170 dated September 13, 2017 "On the establishment of standard values and methods for calculating prudential standards and other mandatory standards and limits, the size of the bank's capital and the Rules for calculating and limits of the open currency position"
Rules #269	Resolution of the Board of the National Bank of the Republic of Kazakhstan No. 269 dated December 22, 2017 "On approval of the Rules for creating provisions (reserves) in accordance with international financial reporting standards and the requirements of the legislation of the Republic of Kazakhstan on accounting and financial reporting"
ICAAP	Internal capital adequacy assessment process
ILAAP	Internal liquidity adequacy assessment process
IRA	Internal Ratings Approach
RbS	Risk-based supervision
AQR	Asset Quality Review
CCF	Credit conversion factor
COSO	Committee of Sponsoring Organizations of the Treadway Commission
EAD	Exposure at default
EL	Expected losses
ES	Expected shortfall
EWMA	Exponentially Weighted Moving Average
GARCH	Generalized Autoregressive Conditional Heteroskedasticity
IRRBB	Interest Rate Risk in the Banking Book
LGD	Loss given default
M	Maturity
PD	Probability of default
RAS	Risk Assessment System
RWA	Risk weighted assets
SREP	Supervisory Review and evaluation process
UL	Unexpected losses
VaR	Value at risk

Dear readers,

It is with special responsibility that I present to your attention the first report on the results of the annual cycle of SREP supervisory assessment. This document, prepared by the Agency, is an additional step towards increasing transparency and strengthening the financial stability of our banks. From 2019 to 2023, the Agency carried out a full transition to risk-oriented supervision in the banking sector.

During this period, such key complementary tools as SREP, regular AQR and supervisory stress testing have been integrated into a single supervisory process. SREP involves a comprehensive analysis of the entire risk profile of a bank with a focus on assessing the adequacy of internal corporate governance and risk management processes. The annual SREP provides an opportunity to assess the strategic priorities of banks, check their ability to withstand economic shocks and identify corrective measures necessary to maintain the stability of the banking system. The use of international standards and best practices, including the methodology of the European Central Bank, ensures high accuracy, objectivity and reliability of the assessment, which helps to strengthen the stability of the banking sector and increase confidence in the financial system. The annual process of assessing banks using the SREP methodology covers 21 banks, a comprehensive analysis of the risk profile of banks is carried out in four main areas: business model assessment, capital risks, liquidity and the corporate governance system. Based on the results of SREP, the banking system demonstrates stability and compliance with regulatory requirements, confirming its ability to function effectively in a changing economic environment. At the same time, areas were noted where there is potential for improvement, which will allow banks to more effectively confront potential challenges and strengthen their position in the long term. I thank all participants in the banking sector for their active participation and commitment to improving risk management. Special thanks go to our team for their professionalism and deep knowledge, which were key to the successful implementation of this important project.

Sincerely,

Madina Abylkassymova

Chairperson of the Agency of the Republic of Kazakhstan for Regulation and Development of the Financial Market

SREP TEAM

Timur Abilkassymov, FRM
Deputy Chairman

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Head of Department

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Deputy Head of Department

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Bakytzhan Japarov, FRM
Credit risk, Liquidity risk

Togzhan Nurmanova
Credit risk, BMA

Yenlik Abilova
Credit risk, Corporate Governance

Margarita Abdulaeva
Credit risk, Operational risk

Key factors:

☑ An updated SREP methodology was implemented in 2024

☑ A specialized supervisory assessment unit has been created within the DBR

☑ Team experience: 70+ years of combined experience in the NBRK and the Agency

☑ 3 FRM-certified specialists, 2 FRM candidates

☑ Expertise: risk management, supervision, methodology, data analysis

☑ The agency supports training: scholarships, agreement with the CFA Institute

SUPERVISION TOOLS

❑ INTEGRATION OF SUPERVISION TOOLS INTO A SINGLE CYCLE

From 2019 to 2023, the Agency successfully completed a full transition to risk-oriented supervision in the banking sector. As part of the development of this area, taking into account advanced European experience, the SREP supervisory methodology was introduced, ensuring a comprehensive assessment of the risks and stability of banks.

2019

- Transition to **risk-based supervision**
- An independent assessment of asset quality **(AQR)** initiated for the first time

2020

- **Reasoned judgment** has become a full-fledged part of risk-based supervision
- The results of the first independent assessment of asset quality have been summed up **(AQR)**

2021

- Bank assessment using **SREP** methodology
- Regular **AQR**
- A system of supervisory stress testing has been developed **(SST)**

2022

- Conducting a full-scale annual **AQR** and **SST**
- Work to improve the **SREP** methodology has begun

2023

- Introduction of a supervisory capital **add-on** based on the results of **SREP, AQR** and the buffer following the results of the **SST**
- Approval of the updated **SREP** methodology

2024

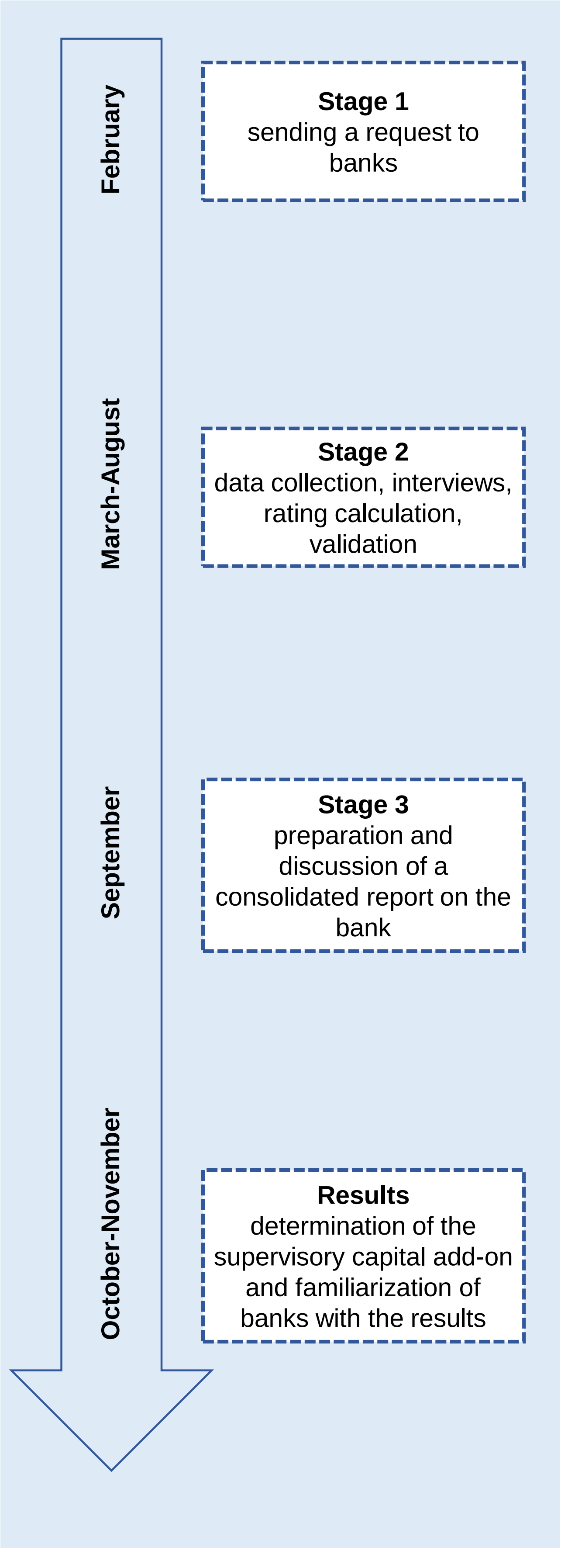
- Application of supervisory capital **add-on** based on **SREP and AQR** and **SST** results buffer

The results of the events conducted demonstrate a significant transformation of business processes in banks:

- key business processes in the area of risk management and corporate governance have been updated
- processes for classifying financial assets in accordance with IFRS 9 have been improved
- collateral assessment processes have been improved
- the level of automated operations in business processes has been increased

SREP SUPERVISORY ASSESSMENT PROCESSES

❑ PROCESSES



In order to identify and prevent risks and deficiencies in the activities of banks, the Agency conducts an annual supervisory assessment using the SREP methodology.

The supervisory assessment of banks includes an analysis of quantitative and qualitative indicators in four main categories: business model of banks; corporate governance; capital risks, including an assessment of the ICAAP and liquidity risks, including an assessment of the ILAAP.

The assessment covers all banks and encompasses three stages.

During the preparatory phase, the Agency sends a request for banks to provide internal documents, reports and other information.

At the second stage, quantitative and qualitative information on key blocks is collected and analyzed. The assessment is carried out on the basis of a questionnaire developed taking into account high risk management standards, regulatory requirements and best practices. For in-depth supervision, interviews with the management and divisions of banks are conducted. Then preliminary ratings are calculated, the ratings are validated by the compliance group and a consolidated report is prepared. The third stage includes discussions with the bank of the consolidated preliminary rating, approval of ratings and measures by the Agency Committee.

Since 2025, a supervisory add-on has been applied as part of the supervisory cycle, which is an additional buffer to the bank's capital based on the results of the SREP and AQR assessment.

❑ RESULTS OF SREP 2024

In 2024, the Agency carried out annual risk-oriented supervision procedures in the banking sector, one of the key elements of which is the SREP supervisory model.

The SREP methodology provides for a comprehensive analysis of the risk profile of all banks in four main areas: business model assessment, capital risks, liquidity and corporate governance system (including risk management, internal control and audit tools).

In 2024, banks were supervised using the updated SREP methodology, developed taking into account the accumulated experience and current challenges of the banking sector. As part of the updated methodology, there was a transition from a "formal" assessment of the presence of risk management and corporate governance systems to a detailed analysis of banks' internal processes. Quantitative and qualitative indicators were revised to provide a more accurate assessment, interviews with bank management were conducted and the assessment results were validated by the compliance group, which ensures transparency and comprehensive analysis.

Based on the assessment of qualitative and quantitative indicators, each bank was assigned a final rating from "1" (low risk) to "4" (high risk):

- 9 banks with "low risks"
- 6 banks with "moderately low risks"
- 4 banks with "moderately high risks"
- 2 banks with "high risks".

9 banks	6 banks	4 banks	2 banks
1	2	3	4

> *SREP is a tool for a comprehensive assessment of a bank's risk profile, rather than its formal compliance with minimum requirements.*

❑ DOCUMENT ANALYSIS

The SREP supervisory assessment perimeter in 2024 included 21 banks, and an analysis of the risk profile of all banks was carried out in four main areas.

During the SREP, more than **23,000 internal bank documents** were reviewed and **105 hours** were spent interviewing banks to ensure a higher level of transparency in the assessment.

The assessment of the business model and strategic risks includes an analysis of the viability of the bank's current model (profitability in the next 12 months) and the sustainability of the strategy (profit for a period of 3 years) based on budgetary and strategic planning.

As part of the **risk capital** assessment, stress testing documents, management reporting, internal audit reports, minutes of meetings of the Board of Directors, internal documents (rules, policies, methods), ICAAP/ILAAP reports were analyzed.

The assessment of **corporate governance** in the Bank covered the corporate structure, strategy, distribution of powers, interaction of management bodies, risk management system, internal control, remuneration policies, reporting and transparency.

The **liquidity risk** assessment included an analysis of the ILAAP, management methodology and policies, limits, stress testing, contingency funding plans, management reporting and Board minutes.

As part of the SREP, from August to September 2024, DBR conducted 21 interviews (an average of 4 hours each) with bank executives, including deputy chairmen, risk managers and line managers. The interviews covered capital risks, budget and strategic planning, economic capital assessment, material risk management, and stress testing integration.

21 banks participated	**991** SREP questions	**105 hours** spent on interviews	**23 000** documents analysed

❑ SCOPE OF WORK

Strategic and budget planning are closely interconnected and occupy a central place in the bank's management system. Strategic planning defines long-term goals and development directions of the bank, helping to adapt to changes in the business environment, anticipate potential risks and opportunities.

At the same time, budget planning focuses on the distribution of resources, serves as a tool for monitoring financial indicators and the implementation of strategic plans.

The analysis of banks' business models was carried out based on an **assessment of quantitative (5 indicators) and qualitative indicators (20 indicators)**. As part of the assessment of qualitative indicators, a comprehensive analysis of internal documents of banks was carried out, which made it possible to obtain a comprehensive understanding of strategic management, financial planning and mechanisms for monitoring the achievement of goals set.

During the analysis of qualitative indicators, the following materials on 21 banks were studied:

1. **Bank's strategy, Bank's annual budget**
2. **Financial model** with different scenarios developed within the framework of the strategy implementation
3. **Risk Appetite Strategy**
4. **Rules for strategic and budgetary planning**
5. **A roadmap** for achieving strategic goals, including key stages and timelines for implementing the strategy
6. **Management reporting** reflecting the extent of implementation of strategy and budget
7. **Extracts and minutes of meetings of authorized bodies and the Board of Directors** for review of reports on the implementation of the strategy and budget
8. **Internal audit reports**

❑ ADVANTAGES

1 Strengthening of the role of risk analysis in planning	• the conducted analysis of qualitative and quantitative indicators showed that banks have **strengthened the role of risk analysis** in strategic and budget planning
2 Fulfilment of strategic goals and objectives	• significant progress has been made in the implementation of strategies and budgets, confirming the effectiveness of existing control and monitoring mechanisms
3 Development of IT strategies	• banks demonstrate consistent development in the field **of IT strategies**, which contributes to increased operational efficiency, improved customer service and strengthening of competitive positions
4 Improvement of management reporting	• there is an **improvement in management reporting**, which indicates increased transparency, accuracy and efficiency in providing information for making management decisions

❑ LIMITATIONS AND RECOMMENDATIONS

Identified limitations	Recommendations based on SREP results
• Some banks lack internal regulatory documents on strategic planning and budgeting • Banks do not draw up roadmaps for implementing the strategy • A number of banks do not use scenario planning	• Develop and implement an internal document on strategic and budget planning with a description of key stages, methodology and management principles • Create roadmaps to the strategy with stages, deadlines, responsible persons and control mechanisms • Develop scenarios for the financial model to assess risks, development options and adaptation of the strategy

Overall, the BMA analysis confirms that banks are **actively improving** their strategic management processes, with a particular focus on **digital technologies, risk management and the quality of financial planning**.

❑ SCOPE OF WORK

Under SREP, capital risks (credit risk, market risk, IRRBB, operational risk) are considered as one of the key elements of supervisory assessment, as they determine the bank's resilience to adverse conditions and its ability to absorb losses.

According to the assessment of qualitative and quantitative indicators in terms of capital risks, overall capital risk management in banks is at an acceptable level: banks maintain a sufficient level of capital to cover significant risks, comply with regulatory requirements and demonstrate stable resilience indicators.

The analysis of capital risks was carried out on the basis of an assessment of **quantitative and qualitative indicators**.

When assessing the qualitative indicators, the following documents were considered in the context of each risk:

1. **Stress Testing Process Documents**
2. **Management reporting**
3. **Internal audit reports**
4. **Extracts/minutes of meetings of the Board of Directors**
5. **Rules and methodology for risk assessment and management**
6. **ICAAP reports**

❑ SCOPE OF WORK

Credit risk is one of the key risks in the banking system and requires a comprehensive approach to assessment and management. The analysis included:

- credit policies;
- creditworthiness assessment procedures;
- collateral policy;
- impairment assessment and reserve formation methodologies;
- management reporting;
- internal audit results;
- rating models.

In 2019, an independent asset quality review (AQR) was conducted, based on the results of which individual action plans for 14 banks were developed. Their implementation over three years was accompanied by systemic changes in the banks' activities. Taking into account the AQR results, amendments were made to the Agency's regulatory legal acts, including: risk management system documents; reserve formation methodologies; prudential standards. The measures taken made it possible to significantly improve the quality of credit risk management processes.

❑ ADVANTAGES

IFRS 9	Banks have implemented internal policies and models for calculating expected losses using PD, LGD and EAD indicators. Macroeconomic parameters and the time value of money are taken into account when calculating risk metrics
RATING MODELS	Some banks use internal rating models developed with the participation of international organizations, including Moody's and S&P
METODOLOGY	Banks have developed methodological foundations for credit risk management. Internal policies have been developed for creditworthiness analysis and collateral requirements, including the procedure and frequency of revaluation
AUTOMATISATION	Banks have done a significant amount of work to automate the collection, storage and calculation of risk metrics as part of reserving and other credit risk management processes

After the implementation of IFRS 9, banks moved to more advanced methods of assessing credit risk, including the calculation of expected credit losses. These changes contributed to the integration of quantitative models into key risk management and decision-making processes.

Taking into account the accumulated statistics of defaults and the aging of loan portfolios, the development of validation processes is becoming an urgent task. Reliable and independent validation of models ensures their sustainability, correctness and applicability in various economic conditions. Validation includes regular verification of scoring, rating and behavioral models based on internal information, as well as updating methodologies taking into account the accumulated empirical information.

Simultaneously, the importance of the transition from exclusively regulatory approaches to the economic calculation of capital based on the principles of the Basel Accord (IRB approach) is growing. The use of such approaches allows for a more accurate consideration of the risk level of a specific portfolio, improves capital allocation and strengthens the stability of the banking system.

A number of organizational and methodological aspects in the process of validation and calculation of economic capital require further development.

❑ LIMITATIONS AND RECOMMENDATIONS

Identified limitations	Recommendations based on SREP results
▪ There is **no independent unit for validation** of scoring and rating models	▪ Create an independent division for validation of scoring and rating models
▪ There is no internal document on the **process of model validation**	▪ Approve internal documents for model validation
▪ Inconsistency in the frequency of validation of credit risk assessment models in 8 banks	▪ Maintain the established validation frequency
▪ 12 banks calculate economic capital for credit risk based on regulatory RWA or using a multiplier	▪ Improve the calculation of economic capital in terms of credit risk instead of RWA/multiplier

❑ SCOPE OF WORK

IRRBB is a significant risk to the bank's capital and income arising from changes in market interest rates. These changes affect the current value of assets, liabilities and off-balance sheet items, as well as future cash flows, which may reduce the bank's economic value and its net interest income.

Effective IRRBB management is critical to the bank's financial stability. Insufficient control over this risk can lead to significant losses and deterioration of the capital position.

IRRBB is assessed and controlled through:

- Market risk management policy;
- Interest rate, currency and price risk assessment methods;
- Limit system and tariff policy;
- Investment instruments and hedging rules;
- Identification, monitoring and stress testing procedures;
- Internal audit results.

IRRBB includes various types of risk that must be taken into account in management and integrated into the internal capital system and decision-making system.

Gap risk

The risk arising from timing differences in the maturity dates (for fixed rate instruments) and interest rate repricing (for floating rate instruments) of a bank's assets, liabilities and off-balance sheet instruments

Basis risk

The risk arising from imperfect correlation in the adjustment of rates received and paid on different instruments that otherwise have similar interest rate repricing characteristics.

Yield curve risk

The risk arises when unexpected changes in the yield curve have an adverse effect on a bank's earnings or its fundamental economic value

Option risk

The risk arising from changes in cash flows due to embedded options

❑ LIMITATIONS

The 2024 SREP supervisory assessment identified a number of areas for improvement in banks' IRRBB management. Key areas requiring improvement include:

- **Insufficient IRRBB Identification.** A number of banks systematically fail to identify the interest rate risk of the banking book.

- **Lack of methodology for calculating key indicators.** In some cases, there is a lack of standardized methods for calculating the economic value of capital (EVE) and net interest income (NII).

- **Risk appetite for IRRBB is not defined.** In some banks, risk appetite for EVE and NII has not been formed. Even if risk appetite exists, its integration into business processes remains incomplete.

- **Insufficient quality of stress testing.** The IRRBB stress testing scenarios used in a number of banks do not comply with best practices.

- **Lack of management communication.** Management at some banks does not receive systematic reporting on the impact of IRRBB on the bank's capital and profitability.

- **Risk appetite does not comply with Basel requirements.** In some cases, the risk appetite for IRRBB is not set in accordance with the recommendations of the Basel Committee (15% of Tier 1 capital).

- **Lack of automated solutions for IRRBB management.** In a number of banks, IRRBB management is carried out manually or using outdated tools.

❑ RECOMMENDATIONS

1	implement behavioral models to account for customer reactions to changes in interest rates
2	provide for regular review of IRRBB management in internal/external Audit plans
3	implement 6 stress scenarios of interest rate shocks in accordance with the Basel recommendations
4	develop and implement a methodology for calculating EVE and NII to systematically assess the impact of interest rates on EVE and NII

❑ SCOPE OF WORK

One of the key categories of capital risk assessment is market risk. Analysis of the bank's exposure to market risk plays an important role in identifying potential losses arising from changes in market prices, interest rates and exchange rates, as well as in ensuring financial stability through timely adoption of necessary measures to minimize them.

As part of the market risk assessment, internal documents were studied, including the market risk management policy, procedures and methods for assessing and managing currency, price and interest rate risks, rules for setting and implementing limits on active transactions, tariff and investment policies, rules for hedging financial risks, as well as procedures for identifying, assessing, monitoring and controlling market risk. In addition, the results of internal audit and stress testing were analyzed.

❑ ADVANTAGES

Based on the results of the assessment of quantitative and qualitative aspects in the market risk assessment block, a number of positive processes are observed in the activities of individual banks:

- risk appetite indicators for market risks have been established, and corresponding limits have been developed and approved

- the main method of calculating market risk is used - one-day VaR with a confidence interval of 99%, as well as factor sensitivity metrics (DV01, KR01 and Duration)

- management reporting includes analysis of market indicators (interest rates, exchange rates, quotes, macroeconomic data), information on the profitability of financial instruments, as well as the results of stress testing and back-testing

- stress testing of market risks is carried out on a regular basis to assess the impact on economic capital and financial stability, and appropriate mitigation measures are developed based on the results of stress testing

❑ LIMITATIONS

At the same time, there are shortcomings in the current practice of market risk management that require improvement:

- banks continue to use a simplified VaR approach based on historical data
- there is no regular internal audit of the compliance of market risk management processes with approved processes, as well as an audit of the effectiveness of these processes
- the Expected Shortfall model is not used to calculate economic capital for market risk in accordance with the Basel recommendations

❑ RECOMMENDATIONS

- ➢ develop and implement more advanced VaR and ES models to improve the accuracy of assessment and improve market risk management
- ➢ consider the use of EWMA and GARCH methods, which take into account the changing volatility of financial markets and adapt to unstable conditions
- ➢ in cases of a clear non-linear relationship between the bond price and its yield, use Duration together with Convexity to take into account the non-linear nature of the sensitivity, and in other cases, perform a fair revaluation using a discounted cash flow (DCF) model to ensure the accuracy of the valuation
- ➢ establish a detailed structure of market risk limits that corresponds to the bank's risk appetite, risk profile and capital level, and approve clear escalation procedures when the limit values are reached
- ➢ anticipate more severe but possible scenarios for stress testing and develop an action plan to minimize their impact based on the results obtained
- ➢ include a review of the methodology for calculating market risks in the audit plan, with an emphasis on the implementation of advanced models with a predictive approach

❑ SCOPE OF WORK

Operational risk is the probability of losses arising from the inadequacy or failure of internal processes, human factors, systems, or external events, including legal risks. Unlike credit and market risks, operational risk is not directly related to fluctuations in the market value of assets or changes in the solvency of counterparties, but is determined by the internal organization and infrastructure of the bank, as well as the degree of reliability of the processes used.

Operational risks can manifest themselves in various forms: from erroneous transactions and IT system failures to employee fraud and poor compliance.

The operational risk assessment includes an analysis of operational risk management policies, operational risk management procedures, operational risk key indicators, operational risk events, operational risk management reporting, operational risk and compliance risk data collection procedures.

❑ ADVANTAGES

- the “three lines of defense” model is applied: division of responsibility and control at all levels in banks
- in some banks, there is an in-depth analysis of major operational risk events with the use of comprehensive measures to minimize them
- the high quality of internal regulatory documents governing the procedures and process of operational risk management

❑ LIMITATIONS

The SREP supervisory assessment found that internal banking systems in some cases did not comply with best practices for operational risk management.

- In particular, the process of collecting operational risk data should be regulated in the bank's internal regulatory documents. The regulations should include minimum data requirements, the procedure for using internal banking systems to collect information, and the procedure for classifying operational risk cases.

The operational risk assessment revealed that the number of operational risk cases related to IT systems and cybersecurity increased during the analyzed period. Due to the high degree of automation of processes, cyber risk management of a bank becomes a complex process covering most aspects of banking activities. In this regard, effective approaches to managing this type of risk should include regular independent cybersecurity assessment, analysis of the bank's resilience in the event of failure of one or more systems, as well as training employees in the basics of cybersecurity during normal operations. In addition, the bank's cybersecurity strategy should regulate the roles and responsibilities of management in the process of managing cybersecurity risks for effective control and monitoring.

❑ RECOMMENDATIONS

- to finalize internal regulatory documents in terms of operational risk management
- revise approaches to assessing economic capital for operational risk
- improve internal banking systems for collecting information on operational risk events
- improve approaches to managing third-party risks

❑ SCOPE OF WORK

One of the basic categories of supervisory assessment according to the SREP methodology is the assessment of corporate governance, within the framework of which the adequacy of the corporate governance and risk management system in banks is analyzed.

Within the framework of the corporate governance category, the Agency analyzed the organizational structure, corporate values, strategy of each bank, distribution of responsibilities and powers in terms of decision-making between the authorized bodies of the bank, mechanisms of interaction and cooperation between members of the board of directors, the management board, external and internal auditors of the bank, procedures and methods of risk management, the internal control system, the remuneration system, the management reporting system, and the transparency of corporate governance.

❑ ADVANTAGES

Based on the results of the assessment of qualitative questions in the corporate governance block, a number of positive processes in the activities of banks are observed:

- an effective organizational structure has been formed that corresponds to the business model, strategy and scale of the banks' activities
- powers in the implementation of risk management processes have been effectively distributed between collegial bodies and structural divisions of banks
- the internal control and risk management system is being improved, allowing for the effective prevention of potential threats and management of significant risks
- independent companies are being attracted to conduct internal audits
- annually, banks conduct an independent assessment of the performance of members of the Board of Directors, which is a good practice that increases the internal efficiency of the business and improves the corporate culture

❑ LIMITATIONS

There are shortcomings in the corporate governance structure and risk management system of banks that need to be improved and optimized:

- banks do not practice assessment of the activities of members of the Board of Directors by independent companies
- there are a number of shortcomings in the competence of the heads of collegial bodies
- there is no maintenance of relevant records in the minutes of meetings of the Board of Directors containing a statement of the issues and decisions considered
- imperfections in the processes of conducting internal audit and a shortage of personnel in the internal control and audit departments

❑ RECOMMENDATIONS

- improve the competence of heads of collegial bodies and bring it into line with the activities of the bodies they head
- regulate in internal documents of banks the preparation of individual development plans by executives
- to maintain the effectiveness of the Board of Directors and its committees, it is necessary to regularly assess their activities. Assistance from external consultants in conducting the assessment can contribute to the objectivity of this process
- keeping relevant records in the minutes of meetings of the board of directors, containing a statement of the issues and decisions considered
- conduct an independent assessment of the activities of internal audit by an independent appraisal company
- consider the possibility of expanding the staff in the internal control and audit departments

❑ SCOPE OF WORK

Liquidity and funding risk assessment is one of the key components of SREP. Liquidity reflects the bank's ability to meet its obligations to customers and counterparties in a timely manner using available cash or highly liquid assets. Insufficient liquidity is a significant risk to the bank's financial stability. Liquidity risk may arise as a result of deterioration in market factors, a decrease in depositor confidence, and an imbalance in the maturity of assets and liabilities.

As part of the liquidity risk assessment, the ILAAP compliance reports, liquidity risk assessment and management methods, internal liquidity risk limits, and the Contingency Financing Plan were analyzed. The stress testing processes were also analyzed, including reports on risk mitigation results and measures, risk appetite levels and monitoring of their compliance, the corporate governance structure with respect to risks, including the procedure for presenting reports to bank management and the responsibilities of bank divisions and management bodies, internal reports, internal audit reports on risk management effectiveness assessment, and minutes of the Board of Directors meetings.

❑ ADVANTAGES

Based on the results of the assessment of quantitative and qualitative questions in the liquidity risk assessment block, a number of positive processes are observed in the activities of individual banks:

- banks have sufficient liquidity, prudential liquidity ratio standards, including LCR, NSFR are met with a reserve

- banks conduct regular stress testing of liquidity risk, using severe but possible scenarios, such as bank run, rapid asset growth and significant reduction in maturity of liabilities

❑ LIMITATIONS

There are shortcomings in the current liquidity risk management practices that need to be improved:

- there is a significant imbalance between the maturities of assets and liabilities
- there is no practice of independent validation of ICAAP and ILAAP by internal or external audit
- there is a significant concentration of sources of liquidity funding
- funding plans do not disclose details of available sources of funding in case of unforeseen circumstances

❑ RECOMMENDATIONS

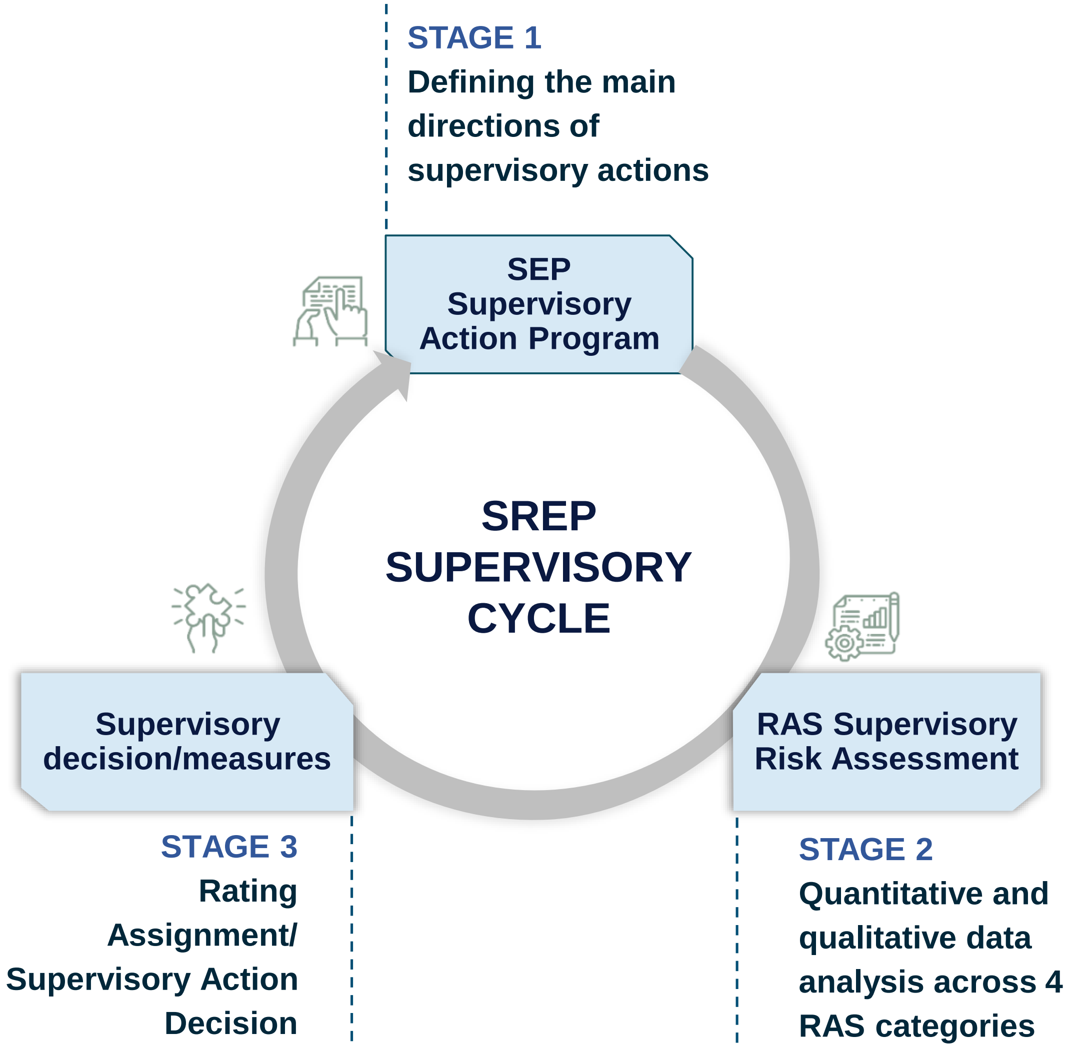
- take measures to attract long-term financing in order to reduce the concentration of funding sources and achieve a balance between loans and deposits
- introduce the practice of conducting reverse stress testing of liquidity indicators and develop an action plan based on it
- expand the list of possible sources of financing in the event of unforeseen circumstances
- develop an internal regulatory document regulating the regular independent validation of the ILAAP and ICAAP
- conduct independent validation of capital adequacy and liquidity assessment models
- develop an effective management information system to provide data on risk and liquidity status to the management and key divisions of banks for prompt management decision-making

The supervisory process according to the SREP methodology is a complete and continuous supervisory cycle and is based on the following three main stages:

I. Drawing up an inspection plan (supervisory action plans);

II. Supervisory assessment of the bank (risk assessment system);

III. Supervisory response measures.

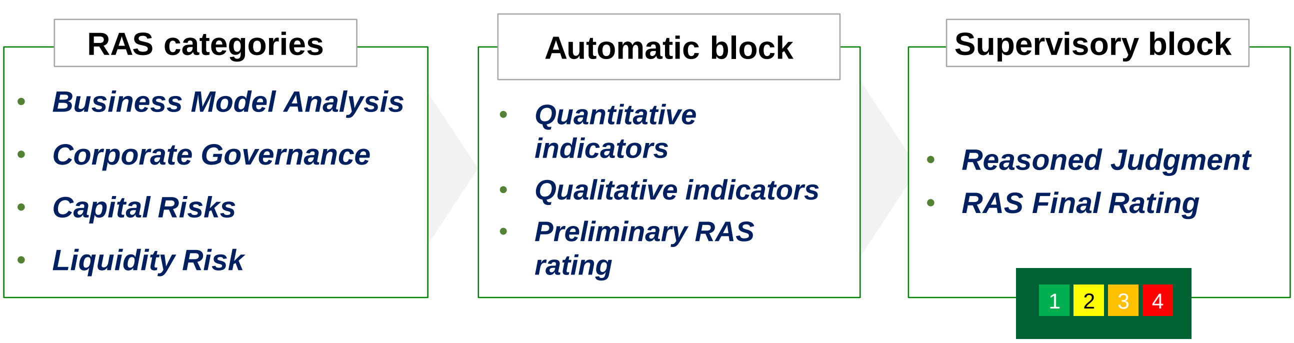


At stage 1, an annual supervisory action program (SEP) is developed. The SEP sets out key areas of supervisory action, determining their priority and level of intensity. The program is based on a comprehensive risk analysis, including the results of the previous SREP assessment, off-site supervision, as well as findings from inspections. Thus, the SEP serves as a comprehensive plan for the supervision of banking activities during the calendar year.

At stage 2, quantitative and qualitative data are collected for risk analysis according to the RAS system, as well as a preliminary analysis of risk factors.

During the assessment, interaction with banks is carried out in order to obtain additional materials and explanations, the SREP rating is calculated and adjusted, and a consolidated report is generated for each bank. Supervisory assessment according to the RAS risk assessment system is carried out based on qualitative and quantitative analysis in 4 categories: business model analysis, capital risk analysis, liquidity risk analysis, and corporate governance and risk management analysis.

The RAS assessment tool combines data and expert judgment in accordance with the principle of "limited judgment", which allows for the best possible compliance of the supervisory decision with the risk profile of a particular bank, as well as maintaining consistency and accountability across the entire financial sector.



Quantitative analysis assesses the level and intensity of risks based on 33 indicators.

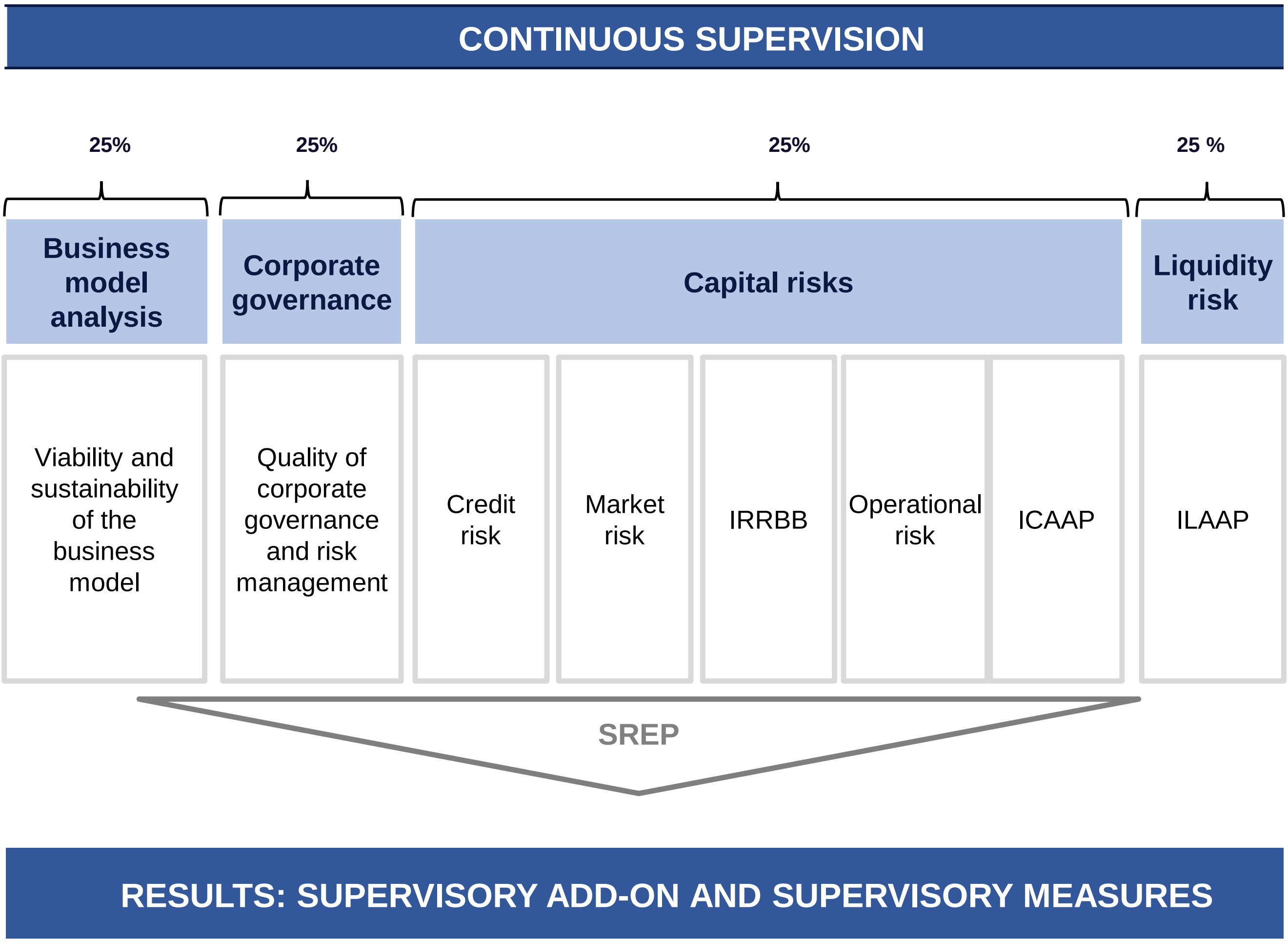
Qualitative analysis assesses risk control and identifies vulnerabilities not covered by the quantitative block.

At stage 3, based on the results of quantitative and qualitative analysis using the RAS risk assessment system, each bank is assigned an SREP rating in accordance with the scale presented below.

Rating	Meaning
1 low risk	The rating is characterized by a high satisfactory level of risk management and internal control, with an assessment of the current level of risk inherent in the bank's activities as "low risk"
2 moderately low risk	The rating is characterized by a satisfactory level of risk management and internal control, with an assessment of the current level of risk inherent in the bank's activities as "moderately low risk"
3 moderately high risk	The rating is characterized by an unsatisfactory level of risk management and internal control, with an assessment of the current level of risk inherent in the bank's activities as "moderately high risk"
4 high risk	The rating is characterized by an unsatisfactory level of risk management and internal control, with the current level of risk inherent in the bank's activities assessed as "high risk"

The final supervisory assessment of a bank determines the bank's risk profile, which determines the extent of the regulator's supervisory policy towards the bank and supervisory response measures to risks and deficiencies identified during the supervisory process. The choice of measures is based on the principles of proportionality, efficiency, balance of expected costs and benefits from application, as well as an assessment of the bank's ability to implement them.

SUPERVISORY PROCESS OUTLINE USING SREP METHODOLOGY*



* illustrative example

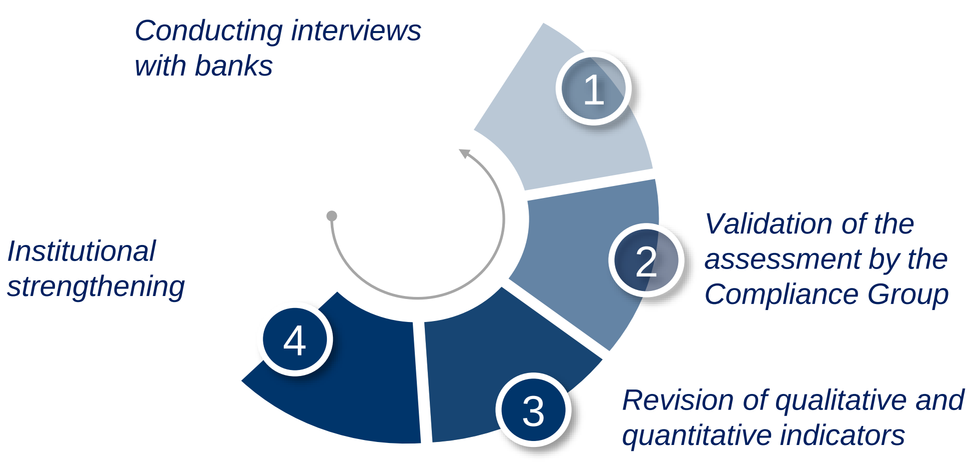
In order to further develop risk management systems and ensure compliance with the best international corporate governance practices, the Agency initiated work to improve the SREP methodology in mid-2022. The basis for revising the methodology was the identified areas for improvement, accumulated experience and conclusions from previous years.

The updated methodology was approved in December 2023 and is aimed at improving the overall effectiveness of the SREP supervisory model. The key difference of the updated SREP approach is the transition from checking the formal availability of internal regulations and internal regulatory documents to analyzing the degree of adequacy and effectiveness of the actually built processes of the risk management and internal control system.

1 **Conducting interviews with banks** ensures a higher level of transparency of the assessment and, in general, a higher transparency of the entire supervisory cycle, providing an opportunity to study the processes built in detail. The interview also serves as an additional feedback channel for banks in the process of building a dialogue with the Agency.

2 **Validation of the assessment by the Compliance Group** allows for a more comprehensive, complex assessment of the banks' risks. The Compliance Group is a collegial group consisting of employees of the methodological, analytical and other departments of the Agency, which verifies the reliability, correctness and consistency of the assessment.

CENTRAL ELEMENTS OF THE UPDATED APPROACH



3 **Revised qualitative and quantitative questions** provide a more accurate analysis of banking activities, allowing for better identification, assessment and management of risks. Based on the results of the RAS system diagnostics, the set of quantitative indicators was updated: the existing ones were optimized and 3 new ones were added instead of the previous 4, which reflect current risks, ensuring a smooth transition to the updated approaches. The new methodology introduces a multi-level structure with sub-questions and criteria of qualitative indicators, ensuring a more accurate and relevant assessment. The number of questions has been increased from 122 to 227, the coverage has been expanded from operations to management functions.

4 **Institutional strengthening with the allocation of a separate unit** for conducting SREP assessment. The presence of a specialized unit allows for a more targeted use of the resources required to conduct SREP. This includes both human and technical resources, ensuring a deeper and more detailed assessment of banks' activities.

In accordance with the principles of Pillar 2 of the BCBS, banks must have sufficient capital to cover their risks, including those that have not been taken into account in the minimum capital requirements under Pillar 1.

Pillar 2 also requires that supervisors assess how adequately banks determine their capital needs relative to their risk levels and, if necessary, take appropriate measures. Thus, the supervisory buffer facilitates an active dialogue between banks and regulators, allowing for a prompt response to identified excessive risks, insufficient capital or deficiencies in risk management. As a result, measures can be taken to reduce risks, eliminate identified deficiencies or increase capital.

The Pillar 2 Requirement (P2R) is a mandatory prudential requirement for a bank's capital, established by the Agency and reflects a supervisory assessment of risks that were not taken into account or were only partially taken into account within Pillar 1.

As part of the development of risk-based supervision in 2023, the Agency developed and approved an internal methodology for the supervisory add-on, which provides for the use of a differentiated matrix approach in determining its amount, is set on the bank's equity capital and is covered by at least 56.25% by core capital (k1), at least 75% by tier 1 capital (k1-2).

The Resolution of the Board of the National Bank of the Republic of Kazakhstan dated September 13, 2017 No. 170 "On the establishment of standard values and methods for calculating prudential standards and other mandatory standards and limits, the size of the bank's capital and the Rules for calculating and limits of the open currency position" defines the following types of supervisory add-on:

- SREP and regular AQR add-on for banks participating in regular AQR, ranging from 0 to 6% of risk-weighted assets, contingent and possible liabilities;

- SREP add-on for banks not included in the regular AQR, ranging from 0 to 3% of risk-weighted assets, contingent and possible liabilities.

Supervisory add-on in the capital structure

Banks included in the AQR perimeter		*Banks not included in the AQR perimeter*	
Core capital (k1)	5,5%	Core capital (k1)	5,5%
Tier 1 capital (k1-2)	6,5%	Tier 1 capital (k1-2)	6,5%
Equity (k2)	8%	Equity (k2)	8%
Supervisory add-on based on the results of SREP and AQR	0-6%	Supervisory add-on based on the results of SREP	0-3%

Min capital + supervisory add-on

Conservation buffer	2,5-3%	Conservation buffer	2,5-3%
Countercyclical buffer	0-3%	Countercyclical buffer	0-3%
Buffer based on supervisory stress-test results	0-3%	Buffer based on supervisory stress-test results	0-3%

**systemic buffer is established at 1%*

Capital buffers

The supervisory add-on based on SREP results, the supervisory add-on based on SREP and regular AQR results are set annually and are valid until a new amount of the corresponding add-on is set.

The supervisory add-on is a key measure for banks and represents an individual additional requirement to the minimum prudential standards and its implementation not only allows for the individual risk factors of an individual bank to be fully taken into account in capital requirements, but also integrates two complementary supervisory tools, such as regular AQR and supervisory stress testing, into the overall supervision process, along with SREP.

Thus, deficiencies in risk management have a material effect on banks. We also note that the amount of the established supervisory add-on should be taken into account by banks when forming their strategy, budget, risk appetite strategy and stress testing scenarios.

In 2025, the Agency will implement activities in key areas identified based on the 2024 SREP results.

Within the framework of **corporate governance,** supervisory activities will be aimed at an in-depth analysis of less effective processes identified during the previous SREP cycle: the composition of the board of directors, management involvement in the risk management process, the internal audit and compliance system.

Supervisory activities in terms of **operational risk** will cover deficiencies identified during the previous SREP supervisory cycle, such as the ineffectiveness of the management reporting system, high loss rates and the lack of measures to reduce operational losses. In addition to the identified deficiencies, the activities will be aimed at improving the quality of internal banking systems and software, as well as ensuring that current operational risk management procedures comply with regulatory requirements.

Based on the results of AQR and remote supervision, inspections are planned for individual and collective loans with a high probability of default, including car loans, consumer loans and mortgages. The interest rate risk of the banking book **(IRRBB)** requires intensive monitoring in the context of yield curve volatility.

Since the methodology, risk appetite and stress testing do not take into account the current behavior of interest rates, IRRBB checks will cover the interest rate risk management system, valuation models and stress testing.

As part of combating money laundering and terrorist financing, activities are planned to monitor compliance with **AML/CFT** legislation.

The 2025 supervisory cycle will include a **model risk** assessment, including an assessment of the model risk management system, validation processes and established risk appetite levels.

In 2025, the **SREP methodology** will continue to be **improved**. As part of this process, it is planned to update the quantitative and qualitative indicators used in the assessment, taking into account changes in the market situation and current conditions in the banking sector.

The above supervisory activities will help reduce systemic risks, increase the resilience of the banking system, and increase transparency and trust in the banking sector.

AUTOMATION OF THE SREP PROCESS

One of the key stages of improving the SREP process is the digitalization of supervisory activities. This step involves the introduction of modern technologies and digital solutions into supervisory procedures, which significantly increases the efficiency and speed of data analysis.

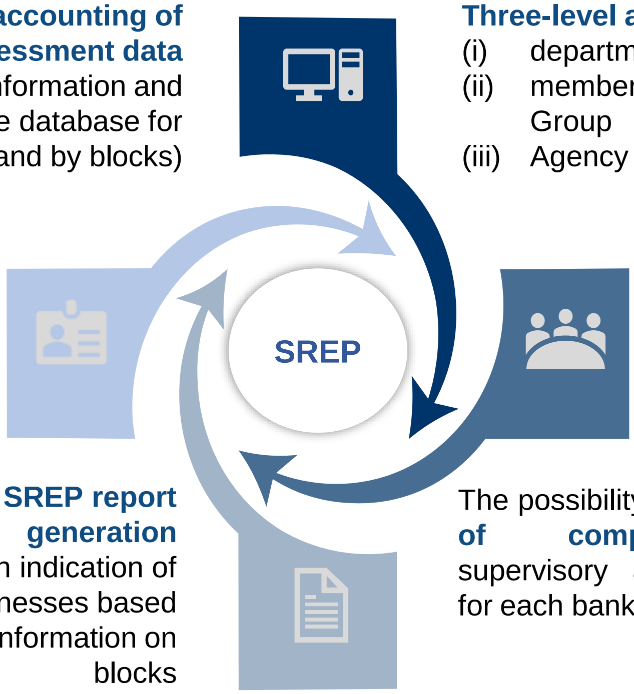
In this regard, within the framework of the SupTech initiative, a SREP web application has been developed and integrated into the supervisory platform. Automated SREP ensures analysis, data and report uploading, improving the systematicity and efficiency of supervisory processes.

«SREP» WEB-APPLICATION

Centralized accounting of supervisory assessment data (storage of information and reports in a single database for each bank and by blocks)

Three-level access for:

(i) department supervisors
(ii) members of the Compliance Group
(iii) Agency management



Automatic SREP report generation for a bank with indication of strengths and weaknesses based on completed information on blocks

The possibility to **track the degree of completion/filling** of supervisory assessment process for each bank and for SREP blocks

Further improvements to the SREP web application are planned, including expansion of analytical functionality, which will be integrated into the comprehensive supervisory application. This application is being developed as part of the Agency's SupTech initiatives and involves the use of analytical tools, including those equipped with machine learning technologies.

Testing is underway to use AI technologies for automated analysis of internal documents and bank policies in order to speed up the SREP assessment and improve the quality of identifying potential risks and gaps.

CONCLUSION

The SREP Supervisory Assessment Report is published by the Agency for the first time. This document will be very useful to all users, as it not only reflects the main results of the supervisory assessment, but also describes in detail the entire process and the methodology used, which makes it significant for understanding the sustainability of the banking sector of Kazakhstan.

The process of implementing risk-based supervision began in 2019 and the first full-scale assessment of banks using the SREP methodology was conducted in 2021. During 2023, the Agency worked to update the SREP methodology, taking into account new approaches and indicators developed based on the accumulated experience of previous years, as well as international standards and best practices. The updated SREP allows not only for a more accurate and in-depth analysis of banks, but also provides an integrated approach to assessing various types of risks, contributing to a more complete picture of the financial condition of banks.

The SREP supervisory process annually involves the assessment of 21 banks and the assessment for 2023 was completed in December 2024. Taking into account the results of the risk analysis based on qualitative and quantitative indicators, 9 banks were recognized as having “low risks”, 6 banks as having “moderately low risks”, 4 banks as having “moderately high risks” and 2 banks as having “high risks”.

A particularly important aspect was the application of an individual supervisory capital add-on for the first time in 2024, which became a key measure for banks. The supervisory add-on allows for the individual risk factors of each bank to be fully taken into account in capital requirements and is aimed at further increasing the resilience of banks to adverse economic changes and helps strengthen the financial stability of the banking sector.

The SREP results and the decision to apply the supervisory add-on were approved at a meeting of the Committee on Prudential Regulation Policy and Financial Market Development of the Agency of the Republic of Kazakhstan for Regulation and Development of the Financial Market.

Thus, according to the SREP results, the banking system demonstrates stability and compliance with regulatory requirements. At the same time, there are areas for further improvement of banks' risk management systems and improvement of internal processes and practices to increase sustainability and efficiency of operations.

Further actions of the Agency within the framework of risk-oriented supervision will be aimed at ensuring the stability of the financial system of Kazakhstan in the long term.

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