Risk Management Policy

1 Introduction and Purpose

The Risk Policy of Access Bank CJSC (hereinafter referred to as the "Bank") has been prepared in compliance with the "Law On Banks", other regulations and normative-legal acts of the Central Bank of the Republic of Azerbaijan, the guidelines of the Basel Committee, the Charter of the Bank and the Risk Management Strategy of the Bank.

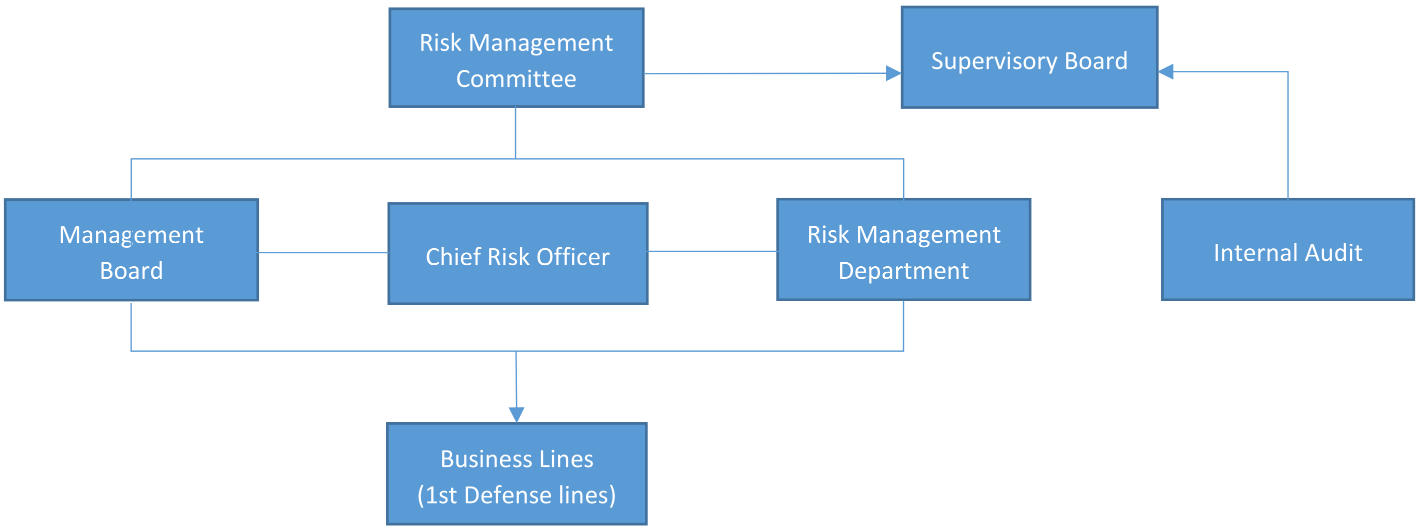
The purpose of the current policy is to delineate the structure and key processes of risk management in the Bank. It presents the main principles of the organization and functioning of the risk management system that corresponds to the nature, scale and operational positioning of the Bank and functions as a framework for the development of additional regulations. It is complemented by additional policies and procedures providing more detail, including the Operational Risk Policy, the Interest Rate and Liquidity Risk Policy, the Risk-Bearing Capacity Policy, The Credit Risk Policy, the FX counterparty Risk Policy, the AML Policy, the Capital Management Policy, the Information Security Policy, and the Business Continuity Policy. The Bank reviews this policy once a year and relevant amendments to the current policy shall be done in case of necessity.

The main business focus of the Bank is the provision of loans to micro entrepreneurs and a full range of Banking services to Small and Medium-sized enterprises (SMEs), as well as to private individuals. The Bank keeps a moderately low risk profile, since:

- Loans and other financial products are simple and straightforward, provided to households or small businesses whose repayment capacity is well understood by the Bank.
- There is excellent diversification with little concentration on any client group, economic sector or geographical region.
- The Bank does not enter into speculative transactions, targets a closed currency position and does not keep a trading book.

2 Organizational structure of Risk Management

Organization of risk management in the Bank is built in below described hierarchical and functional framework:



The Supervisory Board is responsible for the organization and supervision of the risk management function in the Bank. To this extent, a Risk Management Committee (RMC) and an Audit Committee have been established. The Audit Committee oversees the work of the Internal Audit Department and safeguards its independence from management.

The Bank is managed by the Management team, which consists of: The Chairman, Chief Finance Officer, Chief Risk Officer, Executive Director of Corporate, SME and Retail Banking, Executive Director for Micro and Agro Businesses.

2.1 The Supervisory Board

- Defines the Bank's business strategy;
- Is overall responsible for the establishment of a rational risk management system in the Bank, commensurate with the Bank's risk profile;
- Approves the risk management strategy, policy, internal rules and organizational structure;
- Supervises work of Management Board in risk management, receives direct reports from the Chief Risk Officer and/or the Risk Management Department;
- Makes decisions concerning proposals of Management Board/Risk Management Committee about Bank`s risk management practices;
- Approves the risk limits and Statement of Risk Appetite;
- Assesses efficiency of the risk management system at least once a year;
- Approves the Business Continuity Plan;
- Establishes limits for the decision-making authority of the management on risk-taking decisions within the limits established by the charter of the Bank;
- Approves credit exposures that exceed the authority limit set for the bank's Management Board

2.2 Risk Management Committee

- Reviews the risk management strategy, policy, rules and limits and submits to the Supervisory Board for approval;
- Reviews Risk Appetite Statement, risk limits and submits them to approval of Supervisory Board;
- Defines proper methods and tools in order to identify and assess Bank`s risks and determine the frequency of implementation of these tools;
- Reports to the Supervisory Board on the risks to which the Bank is exposed and efficiency of the risk management systems in the Bank;
- Checks/monitors compliance of accepted risks against Risk Management Strategy;
- Prepares proposals to Supervisory Board on improvement of the risk management system in the Bank;
- Evaluates the work of the Risk Management department and the efficiency of the risk management system; informs Management and the Supervisory Board about results;

- Checks compliance of the proposed product/services against Bank`s strategy and business model, evaluate risk of these products considering their price and profitability;
- Submits proposals to the Supervisory Board regarding the responsibilities of the structural sub-divisions and committees performing the risk management functions;
- Monitors reports on Risk Appetite Statement, informs Supervisory Board on limit breaches, giving proposal on adjusting them according to market conditions;
- Reviews the Business Continuity Plan together with Management Board and submits to the Supervisory Board for approval;
- Evaluates the current state of risk culture and takes measures to strengthen it;
- Holds meetings at least once every three months and reports to the Bank's Supervisory Board about their results;
- Reviews monthly reports submitted by the Chief Risk Officer;

2.3 Management Board

- Ensures execution of Risk Management Strategy and Risk Policy;
- Organizes risk management process in the Bank;
- Analyzes exposed risks and take measures on revealed shortcomings;
- Decides on implementation of the new Bank products;
- Submits reports to Supervisory Board and Risk Management Committee on risks and their management;
- Establishes the appropriate environment for the risk management function in order to adequately manage the Bank's risks;
- Reviews Business Continuity Plan together with Risk Management Committee and submits to the Supervisory Board;
- Ensures the cooperation, support of the Bank's other structural divisions for the risk management function and non-interference;
- Implements the business activity of the Bank in compliance with the risk management strategy, the present policy, and the prudential requirements on risks management;

2.4 The Chief Risk Officer

- Develops the risk management strategy and policy considering Management Board`s feedback and submits to the Risk Management Committee;
- Coordinates the activity of the Management Board and structural units of the Bank regarding risk management;
- Reports on monthly basis the results of the monitoring of risk limits, as well as the Bank's risk profile. In case of deviations in risk appetite indicators, immediately informs Risk Management Committee with reasons;

- Provides reliable, transparent, comprehensive and timely preparation of periodic reports indicating the types and volume of risks associated with the activities of the Bank;
- Submits proposals to Risk Management Committee and Supervisory Board on improvement of risk management system;
- Ensures that the Bank's exposure to risks is consistent with its risk-bearing capacity, risk management strategy and prudential risk management requirements;
- Takes measures to improve the knowledge and skills of employees of structural sub-divisions performing risk management functions;
- Participates in the review of the risk management strategy, as well as at the meetings of the Supervisory Board to discuss issues related to risk management;
- Ensures development of regular reporting on the risks facing the Bank;
- Takes measures to strengthen knowledge and skills of the personnel in the Risk Management Department;
- Reports to the Supervisory Board and RMC regarding all risk management issues;
- Supervises the Bank’s Risk Management, Operational Control, Underwriting, Back Office departments and Financial Restructuring and Recovery department.

2.5 Risk Management Department

- Provides coordination of risk management overall;
- Provides the second line of defense in the Bank’s risk management system;
- Develops the Bank’s internal rules for risk management, as well as changes to them;
- Monitors compliance with the risk management strategy and policy, informs Risk Management Committee and Management Board on deviations
- Submits proposals to the Risk Management Committee and the Management Board on risk limits for the different activities in collaboration with the relevant structural units of the Bank;
- Develops all necessary tools for identifying, measuring and controlling relevant risks in the Bank together with the related sub-divisions;
- Submits reports to the Management Board, Risk Management Committee and Supervisory Board on risk assessment, analysis and results;
- Provides feedback on all processes, new products and services that cover the activities of the Bank in terms of risk identification and management;
- Provides assessments of regular business processes as well as new products and services from the point of view of risk identification and management;
- Conducts stress tests in collaboration with relevant structures and develops action plans to reduce identified risks;
- Analyzes data received from other structural units of the Bank for risk management purposes;

- Submits proposals to the Risk Management Committee regarding improvement of adequate and effective control procedures in the risk management process;
- Prepares Contingency Plan with the related departments of the Bank;
- Prepares Risk Appetite Statement and submits to Chief Risk Officer;
- Checks/monitors adherence to Risk Appetite Statement and risk limits and report to Management Board and Risk Management Committee;
- Evaluates the risks and harmful habits that may cause damage to a healthy risk culture and informs Risk Management Committee at least once a year about potential risks;
- Evaluates project risks, submits proposals to the Management Board and Risk Management Committee on taking appropriate measures;
- Prepare and submits Management Board on Residual Risk Report after all necessary measures have been taken;
- Ensures collection and registration of risk events, their assessment in respect to actual and possible losses and preparation of appropriate reports;
- Provides methodological assistance to the relevant structural units of the Bank in risk management;
- Implements stress-tests of the Bank's capital adequacy;
- Develops action plans for the mitigation of the identified risks;
- Develops the Business Continuity Plan together with the Bank's appropriate structural sections and submits to RMC and Management Board;
- Prepares the Bank's risk map, formulates action plans for risk mitigation and monitors implementation;
- Monitors compliance with the risk limits established by the board and informs Chief Risk Officer on any breach
- Prepares and analyzes regular reports for the Supervisory Board, RMC and management on all of the main risks faced by the Bank;
- Fulfils the function of middle office for the Treasury Department, controlling the conformity of transactions with the established limits;
- Ensures the Bank maintains appropriate insurance coverage in line with its risk appetite;

2.6 The Bank's Business Departments

- Manage the risks in the daily activity within the frames of their own authority, providing the first line of defense in the Bank's risk management system;
- Ensure maintenance of the approved risk limits;

2.7 Internal Audit

- Reviews the adequacy of the risk management system;

- Provides reports, proposals and recommendations to the Supervisory Board and Audit Committee regarding the results of the inspections and, ensures information exchange with the Risk Management Department;
- Provides the third line of defense in the Bank's risk management system

2.8 Operational Control Department

- Checks the compliance of branch operations with the Bank's procedures;
- Checks the quality of analysis for Micro loans;
- Forms part of the Bank's second line of defense;

2.9 Underwriting Department

- Reviews and approves loan files for disbursement outside of the limits provided to branches;
- Conducts financial analysis for larger exposures;
- Assigns credit approval limits to the Bank's employees, based on training and testing;
- Forms part of the Bank's second line of defense;
- Conducts evaluation activities for potential collaterals;

2.10 Asset-Liability Committee

- The Asset-Liability committee (ALCO) is a management-level internal committee of the Supervisory Board.
- ALCO is responsible for liquidity management, OCP management and funding activities of the Bank as well as for monitoring the work of the treasury department and issuing guidance for its work, within the frames of the limits approved by the RMC.
- ALCO is responsible for the setting of standard interest rates for loans and deposits

3 Key risk areas

3.1 Credit risk

The Bank defines Credit risk as the risk that losses will be incurred if the party to a transaction cannot fulfil its contractual obligations at all, not in full or not on time. Credit granting is the core activity of the Bank, and accordingly credit risk is the main risk to be managed. The Bank manages credit risk across several different target groups:

Micro business clients: Micro lending is traditionally the Bank's main activity, and the Bank is a recognized expert in assessing and managing the credit risk associated with these clients. The clients have very simple business models and are easily analyzed based on their track record, a visual inspection of the business premises and available documentation. The financial situation is analyzed by the Loan Officer, and loans are approved by the Senior Loan officers and Branch Managers with limited involvement from the Head Office. Due to the small ticket sizes, the risks are exceptionally well diversified, and the preventive control is left with the business department. The Operational Control Department plays an important role by providing a detective control and identifying fraud.

Small, Medium and Corporate clients: These clients have more diversified business than the Micro clients, often with a longer track record and better accounting documentation. They represent larger ticket sizes and are therefore given a higher level of preventive control. Depending on the size of the exposure, clients may be analyzed by the loan officers, but approved with the involvement of the Underwriting Department (in the case of Small exposures), or the Underwriting Department can take full responsibility for the credit analysis (in the case of larger, Corporate exposures).

Retail clients: Retail clients represent the smallest share of the Bank's loan portfolio and are made up of private individuals, based on salary, pension or similar regular income. The most common product is a short-term cash loan. The documentation and financial analysis are very simple, based on documented regular income, and the approach in accordance with the DTI and LTV ratios established by the national regulator. The loan analysis is done either by a loan officer or in the Underwriting Department. Loan approvals are similarly done by branch Senior Loan officers or Branch managers, or in the Underwriting Department.

The main document regulating the credit risk is the Credit Risk Policy. The Risk Management Department monitors credit risk on a portfolio basis, establishes concentration limits and key risk indicators, according to which the risk is monitored and reported.

3.2 Counterparty risk:

The Bank defines counterparty risk, including issuer risk, as the risk that a counterparty/issuer cannot fulfil its contractual obligations at all, not in full or not on time. The risk of the Bank mainly arises from keeping highly liquid assets for the purpose of mitigating liquidity risk, i.e. as a reserve for times of potential stress and not with the aim of generating profits. The Banks strategy is to invest its liquidity safely and to diversify the exposure. The Bank works only with carefully selected counterparties and typically invests its money short term. The Bank additionally has counterparties approved for the payments business and the management of OCP, including spot deals and hedging transactions. The Bank does not enter into any transaction without first approving the counterparty and establishing a limit. The Supervisory Board is responsible for the establishment of these limits, which may partly or fully be delegated to the management Board.

The Risk Management Department monitors and reports on the activities of the Treasury Department to ensure that placements are done in accordance with the approved limits.

The main document regulating this area is the FX and counterparty risk policy.

3.3 Market risk

The Bank defines market risk as the risk of valuation loss or a reduction in expected earnings stemming from adverse fluctuations in market prices. Market risks are interest rate risks, equity risks, foreign exchange risks and commodity risks. In line with its strategy, the Bank does not enter into speculative transactions, equity investments and does not trade on its own account. Therefore, main market risks the Bank potentially faces are Interest rate risk and Currency risk.

In regard to **Interest Rate Risk**, the Bank aims for a balance sheet structure with regard to the re-pricing of assets and liabilities that is adequately balanced across all maturities. The goal is to match re-pricing maturity profiles between assets and liabilities as far as possible. Since Retail customer deposits with fixed rates represent the dominant part of the funding base with majority around 1 year maturity and loan portfolio weighted average maturity typically of 1-2 years represent the dominant part of the asset side, moderate level of gap is identified. The development of the interest rate risk is monitored by the Risk Management Department and reported to the RMC.

The Risk Management Department analyzes the interest rate gap against approved limits on a monthly basis and reports to the RMC. Additionally, any major funding transactions are reviewed by the Risk Management Department in advance to clarify their impacts on interest rate risk. Hedging transactions may be undertaken to reduce the risks identified.

Regarding **Currency risk**, the Bank generally aims to keep a closed position and does not enter into speculative transactions. The Treasury Department manages the OCP in line with limits set by ALCO, the Supervisory Board, and the national regulator. The limits established for Treasury are made available to provide the flexibility to meet the needs of the Bank's clients and to be able to close positions on reasonable terms and are not intended for trading on the Bank's own account. The Bank enters into hedging transactions in local and international markets as needed in order to close positions. Strategically the aim is to balance the currency structure of assets and liabilities so as to reduce the need for hedging operations.

Currency risk is managed on a daily basis by the Treasury department and controlled by the Risk Management department. The development of the OCP is monitored by the ALCO monthly and reported to the RMC.

3.4 Liquidity and funding risk

The Bank defines **liquidity risk** as the risk of the Bank being unable to meet short term financial demands due to unavailability of required funds or inability to convert illiquid assets to cash quickly.

Liquidity risk is managed by the Treasury Department on a daily basis and is monitored by the Risk Management Department and the ALCO on a monthly basis. The main document regulating this area is the Interest rate and liquidity policy. The Treasury Department places liquidity with approved counterparties and instruments in order to earn a return on any liquidity in excess of the operational needs. However, the Bank does not keep a trading book and the objective of the activity is not to benefit from favorable price movements.

In order to manage liquidity prudently, the Bank prepares a Liquidity Contingency Plan. This takes into account the stress testing conducted by the Risk Management Department, which again takes into account the structure and historical behavior of the Bank's liabilities. Given that customer funds play a very important role in the Bank's balance sheet, the Bank sets internal limits, which may be stricter than those set by the regulator.

The liquidity risk is mitigated by the structure of the loan book, which is dominated by annuity loans with relatively short maturities. This ensures a monthly cash inflow from the loan book, which in a crisis situation (unexpected deposit withdrawals) can be utilized as an additional buffer. Additionally, the risk is mitigated by the high granularity of the Bank's deposit portfolio.

Funding risk falls under the purview of the ALCO, and is managed by regular mid-term forecasting, which will allow sufficient time to adjust the plans for loan and deposit growth, as well as to approach wholesale funding counterparts if necessary.

3.5 AML Risk

The Bank defines AML risk as the risk of the Bank's services being misused for the purpose of money laundering or terrorism finance.

AML risk is managed by the Legal and AML/CFT Department, which ensures the collection of data from branches and the regular reporting of transactions to the Financial Monitoring Service as well as the blocking of transactions whenever necessary. The Department likewise reviews new client registrations, checks them against the relevant blacklists and stops the Bank from entering into new business relationships if necessary. The AML/CFT uses the Tonbeller Siron software with AML, Embargo and KYC modules to support the process, and has developed own scenarios for the identification of suspicious client activity.

Decisions about suspicious transactions and clients are escalated to the Internal Control Committee, with the participation of Management Board members mandatory for larger and/or complex cases.

3.6 Operational risk

Under the term Operational risk, the Bank understands the Human Resource Risk (including the risk of internal fraud), Information security risk, IT Risks, Legal, Compliance, External Risk (including the risk of external fraud).

The main **Human resource risk** encountered by the Bank is the risk of fraud committed by employees in the course of their duties. The Bank takes step to minimize this risk in below mentioned ways:

- Creation of a strong internal control environment
- Findings of the Internal Audit and the Operational Control Department
- Adequate motivational structures
- Bankers blanket bond insurance

The control environment is sustained by having clearly written procedures for all main business processes, containing well-defined control points and supported by the IT system. The internal controls consist of a mix of preventive controls, using a four-eyes principle where appropriate, and detective controls for smaller operations. It is further supported by the Operational Control Department which regularly checks the compliance of branch operations with procedures. The motivational structures are based on reasonable fixed salaries, with only a moderate bonus component, so as not to encourage excessive risk-taking.
In case of realized operational risks, the BBB insurance provides a final backstop, secured by major international reinsurers.

IT risk is growing gradually more important for any Bank, as automated systems continue to replace manual labor. In the Bank, these are managed by:

- The development of an off-site back-up server location.

- Ensuring redundancy for key functions in the IT department
- Ensuring adequate documentation for key systems and processes in IT
- Regular external audits of the IT area.

Information security risk is connected to IT risks, but nevertheless a separate part of the Bank's overall risk management. Information security risk management deals with protection of the Bank from possible material, reputational or other damage caused accidentally or intentionally using its information resources and systems. This goal is achieved by classifying the information resources available in the Bank according to the level of confidentiality, ensuring availability of information for only authorized users, and maintaining up-to-date protection against intrusion into the Bank's systems and communication channels. This risk is controlled by the information security officers in the Risk Management Department and is governed by the Information Security Risk Policy.

Legal risk is managed by the Legal and AML/CFT Department, through monitoring of legal and regulatory developments and ongoing review of the policies, products and procedures to ensure their compliance with the legislation in force. Legal Unit reviews the contracts to which the Bank is party, in order to protect legal interests of the Bank.

Compliance risk is managed by the Compliance function, where identification of the clients, collection and maintenance of the data concerning client`s transactions are kept. Bank identifies suspicious transactions, ensures well-documented validation for specific operations in accordance with the local legislation and provides reporting to corresponding financial monitoring body.

External risk in includes but not limited to business disruptions and destruction of the assets in the result of natural disasters, robbery, fraudulent acts of third parties including theft of information, forgery. Bank mitigates external risk through effective insurance scheme where it is possible and economically reasonable.

3.7 Other Risks: Strategic, Reputational and Project Risk

Strategic risk – the risk of selecting inappropriate strategic targets - is managed through the process of strategy development and business planning process, which is driven primarily by the Management Board. Whereas the general strategy is approved by the shareholders, and therefore reflect their wishes, the strategic plan, vision and targets are prepared by the Management Board and submitted to the Board for approval. The process is overseen by the Strategy committee of the Supervisory Board. By drawing in all key stakeholders, the strategic risk is minimized.

Reputational risk presents a fundamental challenge to a Bank like ABA, which depends on the trust of the general public – especially, to maintain a stable refinancing base of retail deposits. The Bank follows its principles of transparency and fairness in its dealings with its clients and the general public. This approach is intended to minimize the reputational risks faced by the Bank. This risk is monitored by the Bank's marketing department by following the mention of the Bank in social networks, the mass media and by tracking complaints submitted to the Bank.

Project risk entails the inability of the Bank to implement the envisaged projects due to lacking internal capacity. This risk is mainly managed by the Bank's business support department through the establishment of a clear methodology for the execution of projects and tracking of their progress.

Key projects are reviewed monthly at the Project Implementation Committee, allowing the management to take timely action in case of deviation from the established timelines.

4 Capital Management

Risk management concept of the Bank is built on ensuring both economic capital management and prudential capital compliance aspects. Therefore, a key objective of the risk management function is the management of the Bank's capital in order to ensure compliance with regulatory capital adequacy, leverage ratios and to establish a Capital management Policy to provide guidance also in the event of a crisis situation. The Bank sets targets for its capital levels in excess of the regulatory minimums with a view to maintaining compliance in the face of potential stress situations and leaving room for projected business growth as per the Bank's strategic financial projections.

The Bank's commitment to maintaining additional capital above the regulatory minimum is supported by the regular stress testing, as outlined in the section below on risk management processes. The risk-bearing capacity framework provides an internal view on the magnitude of the risks incurred and the adequacy of the capital. It does so by taking into account risks that are not explicitly part of the regulatory calculation of capital adequacy. Based on this the Bank establishes its risk appetite within the Bank's risk strategy.

5 Risk management processes

The Risk Management Department is responsible for implementing the main risk processes in the Bank. This refers to the entire cycle of identifying, measuring, controlling and reporting risks.

The main set of risk management processes are related to the assessment and maintenance of the capital of the Bank. A risk assessment is conducted twice per year with the purpose of understanding the magnitude and likelihood of occurrence of the material risks facing the Bank. As an outcome of the process risk maps are developed. The Risk Management Department develops models and scenarios to quantify the main risks that the Bank is already incurring and develops proposals to management for mitigation measures to reduce the amount of risk incurred. Management will either approve such projects – and in so doing take action to reduce the risk levels or accept the risk.

The outcome of the modelling flows into the calculation of the Risk bearing capacity (RBC). The RBC is established as per the CBAR rules on Risk Management as the maximum size of risk able to be borne by the Bank subject to maintenance of the capital, liquidity and other prudential requirements. The modelling carried out by the Risk Management Department establishes the amount of risk already incurred by the Bank. Based on the understanding of the RBC and the risks already incurred, the Bank establishes limits for the incurrence of additional risks, separately for each major category of risks, which together constitute the risk appetite of the Bank. Together with the limits, the Risk Management Department develops triggers in order for the Supervisory Board to be alerted in case the Bank is approaching any of the approved risk limits.

Stress testing is done semi-annually with respect to the Bank's CAR, leverage and liquidity ratios. In the stress testing three scenarios are used: Base case (the Bank's business plan), unfavorable (with up to 50% of the incurred risks materializing), and severely unfavorable (with 100% of the incurred risks materializing). The purpose of the stress testing is to understand the possible future performance of the Bank under stress, and to be able to take timely action to reduce risks or to increase the capital base of the Bank if necessary.

Subsequent to the stress testing, the base case model is subjected to reverse stress testing where the previous model is compared to the actual development and systematic deviations are identified for the purpose of improving the Bank's planning and forecasting capability.

The Risk Management Department is also responsible for developing and maintaining the emergency plan, which establishes several different disaster scenarios and the recovery objectives in each case.

The Risk Management Department ensures the regular and adequate reporting of risks to the Management, Supervisory Board and RMC. The main tool for this is the regular risk report. The Risk Management Department is responsible for the final production of the report but works closely with the Bank's Reporting Department to ensure that the reporting systems adequately record and reflect the risks incurred. This includes ensuring timely identification and reporting of risk, as well as ensuring data quality.

5.1. New Risk Approval process

An additional set of risk management processes relate to operational risk, where the Risk Management Department conducts a new risk assessment process for each significant change to the Bank's business processes, products and services, or before any new product goes into production The assessment is carried out in advance of the implementation of any change and allows Management to take informed decisions to make changes to the proposed processes or to accept the risks.