KELER Ltd.

Risk management principles and strategy

EXTRACT

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1. Introduction

KELER, as the only central depository of the Hungarian capital market and as a specialized credit institution, provides infrastructure for the issuance of Hungarian securities and the settlement of securities transactions.

KELER is the central securities depository subject to the CSDR which provides, in addition to its core services, non-banking and banking type services, therefore it is an institution subject to the Tpt. and the Hpt. as well, in addition to the CRR. It has a special role and position in the capital market, therefore the risks arising are also specific, which is reflected in the internal regulation of KELER.

Legislation and recommendations emphasise the importance of creating a risk strategy and policy, which KELER aims to comply by creating this Regulation.

This document constitutes the highest level regulatory document containing principles and objectives.

2. Risk Strategy

The risk strategy is meant to summarise KELER's approach to risks and risk management. The risk strategy determines the main risk factors, the type of risks that can be taken and the extent to which they are acceptable.

The risk management strategy interacts with the business strategy in force at the time, KELER has developed its risk strategy along conservative and prudent risk management principles. Its methods, processes and built-in controls have also been designed accordingly.

The components of the risk strategy:

- the risk assumption policy,
- the risk appetite (the willingness and the capacity to take risks),
- the risk structure,

2.1. Risk assumption policy

KELER consciously takes certain risks in relation to the core services it provides. Risk-taking constitutes an integral part of KELER's core activity, adapted to its specific tasks among financial institutions and to the possibilities offered by legislation. Accordingly, the objective of risk management is not to minimise risk, but to ensure that the risks inherent in KELER's activities are properly identified, measured, managed and contained within defined limits so that the level of risk generated does not jeopardise the continuity of business operation.

In addition to the risks inherent in the core services, KELER may also take additional risks in relation to its non-banking activities, but mainly in relation to its banking-type services and in order to ensure effective financial activities. Other risks are inherent in the general operation of KELER (e.g. operational risk, general business risk).

The basic principle for risk taking is that KELER **should always have a stable capital position, that its risks should be clear, transparent and adequately covered**, and that **supervisory conditions, regulations and recommendations should be taken into account when taking risks**. KELER’s **risk assumption may not jeopardise the stable provision of critical services and the interests of the clients who use them.**

In order to achieve effective risk management, KELER establishes and continuously develops the risk culture within its organisation.

2.2. Risk appetite

Risk appetite can be defined by assessing the willingness and the capacity to take risks.

KELER, as a nationally critical systemic element, has a low **level of willingness to take risks** due to its role, which is almost entirely determined by the legislation applicable to KELER. CSDR defines the core activities and the scope of complementary activities of KELER, and sets prudential requirements in accordance with other legislation (e.g. Hpt., CRR). Compliance with the law is therefore of paramount importance for the prudent operation of KELER.

For the above reasons, the determination of the rate of conversion of risk and return for KELER is also difficult.

Risks can also be identified in relation to core services, non-banking type services and banking type services at KELER.

The risks associated with the credit institution function are also subject to the legal restrictions relevant for investments and counterparties. In addition to the external constraints, KELER has adopted a conservative investment policy, which means investment in instruments which are simple, transparent and easily measurable in terms of risks.

In addition to the above, the risks taken towards KELER's subsidiary, KELER CCP, play a key role. The amount of risk taken through the size of the share is maximalised, but within this, the actual extent of risk assumption depends on the activity and open positions of clearing members, energy market non-clearing members and their principals, as well as market volatility.

Risk capacity is determined by the amount of own funds, which may be constant in the medium term (1-3 years) or variable depending on profitability and dividend payments. In KELER, the effective free capital is calculated as part of the own funds, that is not committed to cover risks. This part of the capital can be used to cover additional risks, i.e. it expresses in numerical terms the additional risk capacity of KELER. The Board of Directors sets the minimum expected level of actually free capital, derived from the result of the capital plans, which KELER must maintain at all times for the purpose of long-term prudent operation. Due to its prominent role within the system, KELER is expected to be able to hold own funds above the minimum level required by law.

Based on the above, KELER's **risk appetite** is strongly constrained by the regulatory environment and the internal rules reflecting it , compared to traditional banking risks, and therefore the potential risk appetite is significantly limited by regulation.

2.3. Risk structure

The design/development of KELER's risk structure also depends primarily on the regulatory environment (which limits risk-taking). In addition, the restrained internal risk appetite and the activity of the participants in the securities settlement system determine the degree of risk taken by KELER.

In accordance with the legal requirements, KELER shall prepare a comprehensive risk analysis for the Board of Directors at least once a year, in order for the Board of Directors, as the management body with governing powers, to review any changes in the risk structure/profile of KELER and initiate or adopt any necessary changes in the risk management principles and methodologies accordingly. The results of the comprehensive risk analysis are also reported by KELER to the Supervisory Board.

As part of this analysis, KELER updates its risk map every year, compares it with the principles and risk appetite set out in the risk taking policy and examines its consistency with the objectives set out in the business strategy.

3. Risk Committee

Risk Committee is the body that deals with KELER's risks, its purpose is to reveal the risks defined in its rules of procedure and make recommendations regarding their management. Action plans and deadlines proposed by the Risk Committee are accepted by the CEO. Chief Risk Officer reports on the activities of Risk Committee to the Board of Directors and the Supervisory Board.

In addition to the above, Risk Committee also carries out the tasks of the Risk Committee according to the CSDR, that is, it can formulate an opinion and make proposals to the Board of Directors on the principles of risk management and the risk strategy, as well as their consistency with the business strategy.

The Risk Committee provides an opportunity for effective cooperation between the departments and functions operating the first and second lines of defence.

4. Main types of risks

The main types of risk shown on the KELER risk map are:

- The credit risk of CSD links and account-keeping institutions
- Risks assumed towards subsidiary
- Operational risk
- Risk of third parties
- Investment risk