

Central Bank of the Republic of Azerbaijan

REPORT
ON ACCOMPLISHMENT OF MAIN GOALS AND
FUNCTIONS IN 2020

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Introduction

The economic and military potential created for many years as a result of purposeful policy and deep reforms implemented under the leadership of the President of the Republic of Azerbaijan Ilham Aliyev resulted in the brilliant victory of our victorious army in the Patriotic War in 2020 and the end of nearly 30 years of occupation.

Also, in 2020, the Azerbaijani economy once again proved its resilience. The anti-crisis program, implemented in the context of a deep epidemiological crisis, strong shocks from the external environment, slump in oil prices and finally Armenia's aggression against Azerbaijan in September, protected the economy from a deep recession. Negative effects of the COVID-19 pandemic, which has a strong impact on all spheres of public life and economic activity, were effectively managed over the year.

The Central Bank of the Republic of Azerbaijan discharged its mandated functions in 2020 as well, as a result of concerted measures with the government, macroeconomic stability was safeguarded, price stability and balance in the FX market was maintained. Monetary and macro prudential easing helped prevent further fall in economic activity and partially compensate losses in income of economic entities.

1. Accomplishment of goals

The goal of the Central Bank is to maintain price stability, organize and ensure operation of interbank centralized and other non-licensed payment systems, and support banking system stability within the authorities established by the legislation.

1.1 Maintaining price stability within the authorities established by the law

In 2020 the Central Bank maintained price stability, inflation was within the announced target band ($4\pm 2\%$).

According to official statistics, in December annual inflation was 2.6%, below the target band center. Food prices contributed 2 pp, non-food prices 0.3 pp and services 0.4 pp to annual inflation fluctuation.

Price dynamics on main sub-categories of the consumer basket varied. The main component of the consumer basket – food still has a considerable share in price hike. Price inflation has been 4.6% over recent 12 months. Price hike was 4.1% on food products, 4% on alcoholic drinks and 18.5% on tobacco products. Global food price swings also weighed on food inflation; in 2020 global food prices hiked by 6.5%. Annual hike on the deep components of inflation – non-food products and services was 1.2% and 1.1% respectively. Low non-food inflation is mainly attributable to deferred demand due to the pandemic.

Average annual core inflation calculated by excluding swings in regulated prices and prices for seasonal agricultural products was 2%.

Though increased over recent 2 months, the diffusion index – a measure of change in dynamics pertaining to the number of goods and services with rising and falling prices in the

consumer basket has been lower than the early year.¹ In general, over recent 12 months prices for 69 out of 520 goods and services decreased, and prices for 44 remained unchanged. Price hike for 58.7% of products was below 2%.

In general, amid pandemic driven uncertainties low consumer and investment expenses and low aggregate demand, exchange rate stability, the monetary condition and inflation expectations had a stabilizing, while additional expenses faced by economic subjects to protect from the virus and global food price hike an increasing effect on inflation. The FX market stability was the key in maintaining inflation within the target band.

In December the agricultural producer price index decreased by 0.2% over recent 12 months. Prices rose by 0.1% on animal and by 1.1% on plant growing products on annual. In parallel, producer prices decreased by 2.7% on forestry and by 2.6% on fish and fish products.

The industrial producer price index decreased by annual 16.8%. Price swing was mainly attributable to the mining industry (down by 27.2%). Price slide in the mining industry is mainly due to the dynamics of global oil prices. Producer prices decreased by annual 5.7% in processing. The highest price slide in the processing industry was in production of oil products (20.3%), printing services (9.6%) and tobacco products (6%).

Annual prices for transportation services remained nearly unchanged. In addition, prices for postal and courier services dropped by 0.1%, and remained unchanged in communication services.

External sector developments, actual dynamics of inflation and balance in the FX market were the main factors determining the dynamics of inflation expectations. Inflation expectations increased amid negative impact of the pandemic in Q1, decreased as of the yearend. 12-month expectations of households were higher in Q1, but started to decrease from Q2. The share of respondents expecting high inflation according to the survey conducted among households in December decreased by 13 pp to 12% vs September. Inflation expectations of real sector entities were close to the actual inflation.

1.2. Organization and ensuring operation of interbank centralized and other non-licensed payment systems and support for banking system stability

Stable and reliable operation of payment systems was one of the priorities for the Central Bank. Interbank centralized payment systems, the key components of the National Payment System (NPS), launched and managed by the Bank maintained uninterrupted operations in 2020.

Total size of payments via the Real Time Gross Settlement System (AZIPS) and the Low Value Payments Clearing and Settlement System (LVPCSS) for small size and reiterating payments, the core components of the NPS, amounted to AZN223.4B (3.1 times of GDP) , 59.8 mln transactions.

Preventive measures in payment systems kept being implemented to avoid rising cyber threats in global e-environment in 2020 as well.

¹ The index is calculated as $(\text{increasing-decreasing})/(\text{decreasing+unchanged})$

The infrastructure of the Government Payment Portal (GPP), created for centralized collection of budget and mass service payments, continued to expand in the reported period. 13 central executive power institutions, 4 utility enterprises, 5 landline and mobile communication operators, 114 judicial bodies, 19 insurance companies, 1438 municipal bodies and other socially important institutions were integrated to the GPP. Now payments are made for over 800 services on the institutions integrated to the GPP via 26 banks and about 2500 payment points of the Azerpost LLC, about 1300 payment terminals in cash and in a cashless form. Total volume of transactions conducted over the GPP amounted to AZN3.3B (54% cashless payments). Cashless transactions y/y increased by 22%.

Development of the card infrastructure followed a positive trend in 2020. Business continuity of the Interbank Card Center (ICC) established to provide processing of data on transactions between service centers using payment cards issued in the country was maintained. 53.2 million card transactions were conducted over the ICC, national currency denominated transactions amounted to AZN2.8B, foreign currency denominated transactions amounted to USD14.6M and EUR3.1M. Total number of transactions processed in the system y/y increased by 2.4 times, and the size by 2 times on AZN, 42% on USD and 4% on EUR.

As of 01.01.2021 payment cards in circulation numbered 9.6 mln, the number of ATMs was 2779 pcs, POS-terminals 57344 pcs. Domestic payment card transactions y/y increased by 26% to AZN28.1B. The size of domestic cashless transactions with payment cards increased by 34% to AZN6.4B. The number of e-trade operations y/y increased by 55% to 68.7 million pcs, while the size increased by 22% to AZN3.9B.

Contactless payment indicators also followed positive dynamics. Contactless payment cards in circulation y/y increased by 2.5 times to 3.7 mln pcs; the number of POS-terminals accepting contactless payments increased by 13% to 34.2 mln pcs. The number and size of contactless payments y/y increased by 4.3 and 5.4 times respectively.

Significant progress has been made in statistics on e-banking services, one of the main challenges of nowadays. Total number of customer transfers from current accounts via e-banking in 2020 reached 42.4 million pcs, and the volume AZN95.7B. The number of transfers y/y increased by 79% and the volume by 55%.

According to the 'State Program on expansion of digital payments in the Republic of Azerbaijan for 2018-2020' approved by Decree# 508 of the President of the Republic of Azerbaijan dated 26 September 2018, the Central Bank successfully continued efforts to expand cashless payment infrastructure among citizens, business entities and public institutions, minimize cash circulation and shape a cashless society.

The 24/7 Instant Payment System (IPS) created to expand the coverage of use of digital payments as part of the implementation of the State Program was commissioned on 1 October 2020. The system allows settlements between businesses, individuals and public institutions to fully complete within 5-10 sec irrespective location and time. As of 01.01.2021 17 banks, the State Treasury Agency of the Ministry of Finance of the Republic of Azerbaijan and the Azerpost LLC have been integrated to the IPS platform.

To expand financial banking services as part of the State Program the Central Bank commissioned the Digital Identification System (DIS) on 13 October 2020. The Hyperledger Fabric block chain platform was used in creation of the DIS and information is stored in a distributed registry technology based database with complete confidentiality. At the same time, main priorities were to increase the coverage of offered e-banking services, establish customer-bank relations on a more modern level, raise these services to a qualitatively new level by creating them on the latest technological solutions and, as a result, increase customer satisfaction. The project provides an opportunity to open bank accounts and obtain payment cards as a pilot with the identification of customers in accordance with the 'know your customer' policy when accessing financial and banking services remotely by legal entities and individuals. Thus, the system allows to promptly access banking services from a distance without approaching the bank, eliminates the necessity to provide the required information on paper and maintains completeness, accessibility and confidentiality of information. As of 01.01.2021, 10 banks have been integrated into the DIS platform.

Over the period the Bank together with the representatives of the SWIFT – the Society for Worldwide Interbank Financial Telecommunication, selected as a consultant to develop an actions plan for the financial system of the country to transit to the ISO20022, held meetings with leading banks with various automated operation systems, securities market participants, non-bank credit institutions and insurance companies and evaluated the current situation. The 'Actions Plan on application of the ISO20022 international standard in the National Payment System infrastructure of the Republic of Azerbaijan' was developed on the basis of conducted analyses and approved. Application of the ISO20022 in the NPS infrastructure will allow establishment of single data formats on exchange among payment system participants, minimization of risks in payment transactions, decrease resources allocated to automation (finance, time, human), and creation of wide reporting functionalities.

To form a modern payment ecosystem, create a legal basis for development of innovative payment solutions, as well as strengthen protection of the rights of payment service users, the Central Bank prepared and submitted to the Cabinet of Ministers of the Republic of Azerbaijan for review a draft 'Law on Payment Services and Payment Systems'.

To elevate financial inclusiveness, diversify channels for provision of banking services, in particular, provide effective access of low-income groups to banking services the Central Bank together with the Azerbaijan Bank Association developed and introduced to the banking sector a free package of 'Basic banking services' proposals for low-income groups over the reported period. The 'Basic banking services' package includes free of charge opening of bank accounts for low income groups, delivery of free debit payment cards, no service fee on encashment operations, no service fee on payments made via e-banking services and a number of other discounts.

The Bank focused on literacy and promo campaigns on cashless payments and held many stimulating and awareness events with international card organizations and related authorities to promote use of digital payments and formulate cashless payment habits among the population. In particular, during the coronavirus (COVID-19) pandemic to stimulate contactless payments the Central Bank provided a wide promo campaign and

developed educational videos that were constantly broadcast on TV channels and placed on the Internet resources of the Bank.

To minimize effects of the coronavirus (COVID-19) pandemic service fees applied by the Central Bank to transfers through the National Payment System (the AZIPS and the LVPCSS) were reduced by 50% in 2020.

2. Discharge of functions

To attain main goals the Central Bank took necessary efforts to establish and pursue the state's monetary and exchange rate policy, organize cash circulation, regularly set and announce the exchange rate of manat against foreign currencies, regulate and control currency, develop reporting balance of payments (BoP) and participate in development of the forecast BoP, maintain and manage international gold – foreign exchange reserves at its disposal, compile consolidated (both public and non-public) foreign debt statistics and international investment balance and discharge other functions under the legislation.

At the same time, in accordance with Item 1 of Decree No. 1616 'on improving management of the system of regulation and supervision in the financial services market' of the President of the Republic of Azerbaijan dated 28 November 2019, authorities of the financial markets supervisory authority, including its duties and rights on licensing, regulation and supervision in the financial services market, and protection of the rights of investors and financial services consumers were transferred to the Central Bank. In 2020 the financial stability policy was mainly oriented towards safeguarding stability of the financial markets and system, minimize negative impact of the pandemic and support the population and businesses. Despite the pandemic driven situation, efforts to expand financial intermediation and deepen financial markets continued.

2.1 Setting and implementation of the state's monetary and exchange rate policy

In 2020 the monetary policy of the Central Bank was oriented towards managing inflation within the announced target band ($4\pm 2\%$). Monetary policy decisions strived to neutralize threats to macroeconomic stability from external and internal environment amid the pandemic and prevent dramatic slump in aggregate demand keeping inflation within the target band.

The monetary and exchange rate policy was implemented in accordance with the 'Statement of the Central Bank on main directions of the monetary policy for 2020 and medium term'. Monetary policy decisions were taken in light of analysis of macroeconomic developments and updated macroeconomic forecasts.

Accommodation of the monetary condition at the expense of both the value and the quantity of money continued. Decisions related to interest rate corridor parameters served to maintain an optimum balance between supporting economic activity and safeguarding macroeconomic stability amid the pandemic. Interest rate corridor parameters were discussed 8 times in 2020 – the refinancing rate was reduced stepwise from 7.5% to 6.25%, the ceiling of the interest rate corridor from 9.25% to 6.75%. The floor of the corridor was

left unchanged at 5.75%. In general, the refinancing rate has been reduced by 2.4 times since early 2018 (from 15%).

Base money in manat increased by 11.6% to AZN13.6B by the yearend. The structural element of money base in manat – cash in circulation (cash beyond the banking system, cash in banks' cash offices and ATMs) increased by 13.8%, balance of correspondent accounts in manat decreased by 1.2%. Change in the balance of a single treasury account, that depends on state budget revenues and expenditures, was the main factor of change in money supply. Central Bank's critical targeted liquidity support to the economy amid the pandemic also weighed on money supply. In general, money supply has increased by 63% since early 2018 when monetary policy started to be eased in terms of cost.

Broad money supply (M3) increased by 1.1% to AZN29.2B as of the end-period. Broad money supply in manat (M2) increased by 11.3% to AZN20.3B as of the end-period. Cash in circulation, demand and term savings and deposits in the structure of money supply in manat (M2) performed differently.

Cash in the structure of broad money supply increased by 13.4% (53.1% of M2), manat denominated demand savings and deposits increased by 20.3% (34.9% of M2), while term savings and deposits decreased by 14.1% (12% of M2). High growth rate of manat denominated demand savings and deposits displays that we are moving towards a cashless economy.

Monetary easing was accompanied by drop in yield on Central Bank's deposit operations and short-term notes, as well as government securities. Interest rates in the interbank market, and deposit and credit rates balanced between risk premium and eased monetary condition. In general, average interest rates on manat denominated new loans have decreased by 3.9 pp since January 2018. High risks triggered in the real sector by the pandemic contained further drop in interest rates.

Dollarization of deposits kept decreasing. Foreign currency denominated savings and deposits in money aggregates accounted for 30.4% of total savings and deposits in 2020 (36.8% in 2019). Dollarization of savings of individuals was 50.8% at the end of 2020.

The Central Bank adequately used various market operations to effectively manage liquidity in the economy. Demand on Central Bank's sterilization tools varied across months in response to the liquidity position of the banking system. To mitigate threats posed by the coronavirus pandemic to macroeconomic stability and the FX market the Central Bank changed maturities of sterilization tools, thus reducing duration of the sterilization portfolio. Hence, the Bank started to conduct 14-day deposit auctions instead of 28-day deposit auctions, and only 28-day notes are placed instead of long-term note auctions from Q2 onward. The Central Bank held 62 deposit auctions and 46 auctions on issue of notes. As of end-2020 balance of funds attracted through deposit auctions made AZN300M. In general, total outstanding amount of sterilization via notes was AZN650M as of end-year.

Over the year demand prevailed over supply at deposit auctions and issue of notes, as a result yield on these tools approached the floor of the interest rate corridor.

Return on sterilization tools translates into interest rates on other financial tools becoming an important representative indicator of the money market. Also, Central Bank notes actively used in the REPO market as collateral push interbank market activation.

Reserve requirements were left unchanged and are still applied on an averaging basis, to allow banks flexibly manage liquidity. Monitoring findings display that banks' cumulative balances on correspondent accounts with the Central Bank exceeded total funds to be maintained as required reserves.

The Bank focused on effective communication of the monetary policy. Over the year the Bank published press releases with relevant analytical comments and held regular press conferences on each policy decision under the previously announced schedule. The monetary policy review was released on a quarterly basis. Central Bank's activities were highlighted in its official website, as well as via Twitter and YouTube. The Bank opened an official Facebook account at the end of 2020.

2.2 Organization of cash circulation, issue of currency to and withdrawal from circulation

The Central Bank covered demand of the economy for cash in full, adequately and in time in 2020 under Part II, Article 19 of the Constitution of the Republic of Azerbaijan and the 'Law of the Republic of Azerbaijan on the Central Bank of the Republic of Azerbaijan'.

The Central Bank withdrew AZN12.5B or 492 mln. pcs of currency from and issued AZN13.9B or 556 mln. pcs of currency into circulation. In general, cash in circulation increased by 13.8% (AZN1.4B or 64 mln pcs) early year to AZN11.8 B as of the end-year.

The Central Bank continued modernization of our national currency with the application of the latest innovations in the field of banknotes, nano and micro technologies, and over the reported period security systems and design of 1, 5 and 50 manat banknotes were renewed within the existing concept and issued to circulation early in 2021.

The 'Clean money in circulation' policy adopted to improve the quality of money in circulation kept going, AZN8.8B worth currency withdrawn from circulation was processed in automated systems and fit currency was reissued to circulation; AZN2.0B worth unfit currency was withdrawn from circulation. AZN5.4M worth currency was replaced by the service cash offices created at the Central Bank.

Amid the current pandemic the Bank took a number of measures to minimize the risk of spreading coronavirus (Covid-19) infection, including storing currency from circulation in a special quarantine regime in treasuries of the Bank, processing them in automated systems upon expiry of the period and issuing high-quality money to re-circulation.

Over the reported period the Bank detected, withdrew from circulation and delivered to law-enforcement bodies 628 pcs (AZN29 523) of counterfeit currency, y/y down by 30%. The number of counterfeit banknotes per 425 000 pcs of banknotes was 1, considerably low compared to relevant indicators of other countries (the rate in the euro area is 1 fake currency per 59 thousand pcs, 1 fake currency per 143 thousand pcs in Russia). As part of anti-counterfeiting, the Central Bank provided prompt information sharing with law enforcement bodies integrated to the 'Counterfeit Banknote Monitoring System' launched by the Bank.

Over the year, webinars on renewed 1, 5 and 50 manat banknotes and counterfeiting currency were organized for employees of commercial banks and other organizations specialized in cash as part of currency related awareness-raising activities.

In general, the Central Bank focused on the priorities like optimal and safe management of national currency reserves, provision of high-quality banknotes in circulation, continuous modernization of critical information systems, as well as digitalization of business processes in cash management.

2.3 Regular setting and announcing the official exchange rate of manat against foreign currencies

In 2020 the exchange rate of the manat against foreign currencies reacted to supply and demand in the FX market. Despite negative effects of external environment developments concerted preventive efforts by the Government and the Central Bank resulted in safeguarded stability.

The Central Bank organized both scheduled and off-schedule auctions for the sale of currency of the State Oil Fund of the Republic of Azerbaijan (SOFAZ). The Bank held total 102 currency auctions. Demand at Central Bank's currency auctions varied from month to month, depending on expectations from indirect effects of external developments. In March, amid tightened quarantine measures against the coronavirus (COVID-19) pandemic in many countries, dollarization accelerated as a result of expectations related to slump in oil prices on global commodity markets, and demand for both cash and non-cash currencies increased sharply. However, timely response to the situation, full coverage of market demand due preventive sale of SOFAZ funds, effective organization of bank exchange offices in a very complex pandemic situation, open communication with the market allowed to quickly achieve stability. A new financial tool allowing to regulate banks' currency positions was introduced. As a result of subsequent relative recovery in global oil prices and improved expectations due to stabilization in currency markets of partner countries supported FX market stability. Against the background of low demand for foreign currency in the months to come, SOFAZ's preventive sales were fully resumed by the yearend.

The official exchange rate of the manat was set on the basis of the average exchange rate on interbank transactions in 2020 (both auction and over-the-counter on the Bloomberg platform). The average daily AZN/USD exchange rate was AZN1.7. Buy-sell exchange rates set by banks were close to the official one. Commercial banks' daily average buy/sell rate was 1.6991/1.7025. Difference between average daily official buy/sell exchange rates and those of commercial banks was 0.009/0.0025.

The exchange rate of the manat varied against currencies of trade partners – it appreciated against the Turkish lira, the Kazakhstani tenge, the Russian ruble, the Ukrainian hryvnia and the Georgian lari and depreciated against the euro, the Swiss franc and the Japanese yen. Dynamics of bilateral exchange rates influenced that of multilateral exchange rates. Total trade weighted non-oil nominal effective exchange rate (NEER) of the manat appreciated 6.3%, and the real effective exchange rate (REER) by 4.1%. Inflation in Azerbaijan being lower than average inflation in trade partners had a downward effect on

the REER. To note, the REER of manat has depreciated by 30.9% since end-2014, contributing to long-term non-oil competitiveness.

2.4 Currency regulation and control

The Central Bank maintains currency regulation according to the Law of the Republic of Azerbaijan on Currency Regulation. Currency relations are regulated by the above Law and the following regulations of the Central Bank:

- The 'Regulations on currency operations of residents of the Republic of Azerbaijan in foreign currency and non-residents in national and foreign currencies' approved by the Management Board of the Central Bank on 28 November 2016;

- The 'Regulations on bringing foreign currency into and taking out of the Republic of Azerbaijan by residents and non-residents' approved by the Management Board of the Central Bank on 3 March 2016;

- The 'Regulations on organization and exchange operations of currency exchange offices' approved by resolution #44/1 of the Management Board of the Central Bank dated 29 December 2015;

- The 'Regulations on maintaining currency exchange operations by the persons licensed for currency exchange activities' approved by Resolution #47/1 of the Financial markets Supervisory Authority dated 21 December 2017.

Over the past period the Central Bank licensed one legal entity applied to be engaged in currency exchange activities.

The currency regime applied in the country served the purpose of stabilizing the FX market and balancing the balance of payments within the framework of comprehensive measures aimed at financial stability. However, taking into account difficulties and problems related to application of a strict foreign exchange regime, especially regulation of advance payments on import operations, and numerous appeals of entrepreneurs to state and government bodies, to the Central Bank, some changes were made to the currency regime. Thus, the period (270 days) for import of goods under import contracts was extended up to 2 years, and liability measures were removed for the cases where the value of goods imported not in exchange for advance payments or non-refundable currency is less than \$10,000. These changes allowed many entrepreneurs engaged in foreign economic activities to import goods in exchange for advance payment, especially in the face of the problems caused by the global pandemic, establish business relations with foreign exporters, and return funds to the country in optimal time if imports are not possible.

At the same time, to increase effectiveness of currency control, prevent illegal taking of foreign currency from the country, targeted measures were taken to strengthen monitoring and control by currency agents (banks) over foreign exchange transactions of residents and non-residents, as well as prevent suspicious transactions.

Analysis showed that the applied currency regime played a positive role in optimizing the ratio between inflow and outflow of foreign currency into and out of the country in 2020 too. In this case, under the Law of the Republic of Azerbaijan 'on Protection of Foreign Investment' and international treaties on mutual promotion and protection of investments

seconded by the country, a free currency regime is provided for repatriation of foreign investments, transfer of income earned by foreign investors and other payments abroad.

2.5 Storage and management of international gold-foreign exchange reserves at its disposal

In 2020 the Central Bank managed foreign exchange reserves in the context of the global economic shock caused by the pandemic and accompanied by large-scale monetary and fiscal stimulation at an international level and the main priority for the foreign exchange reserves management policy was to safeguard their safety and liquidity.

In line with the foreign exchange reserves management strategy and regulations, the FX reserves of the Central Bank were divided into investment tranches, which are operational and savings instruments that ensure current operations, and each tranche was managed according to its purpose. The operational tranche, that directly supported the Central Bank's monetary policy over the current year, is maintained in the US dollar, the dominant currency of foreign economic activity. The investment tranche, which serves the purpose of generating investment income, is maintained – 90% in USD, 7% in EUR and 3% in GBP. As a result, by the end of the reported period, 90% of official FX reserves were in USD, 5% in EUR, 2% in GBP and 3% in SDR.

To make the management effective, the Central Bank's FX reserves were invested in liquid and high quality government, quasi government and corporate debt liabilities. The investment portfolio was broadly diversified across financial tools and countries, and main focus was on analysis of global macroeconomic environment and foreign financial markets.

Along with internal management, the Central Bank continued to cooperate with foreign managers in the management of foreign exchange reserves in 2020. Effectiveness of investment portfolios further increased with the use of the services of foreign managers, as well as measures were taken to transfer advanced best practices to internal management.

In 2020 Central Bank's official FX reserves increased by \$112M (1.8%) to \$ 6.4B as of the end-period. The Bank earned \$93,65M worth income from currency asset management.

2.6 Development of the reporting and participation in development of the forecast balance of payments under the legislation

Compiling of the international standards based BoP continued over 9 months of 2020, actual and forecast indicators of the BoP were one of the critical information sources for adequate decisions in the macroeconomic policy.

Cross-references via the International Transactions Reporting System (ITRS) allowed to further purify the reporting and accounting system of the BoP, deepen analytics, reconcile indicators and improve forecasting. As part of the ITRS to further improve review and processing of statistic indicators, transactions on commercial banks' deposits in foreign accounts and cash currency item, advance payments transferred abroad to import goods and services to the country and remittances of individuals were cross reviewed again.

At the same time, more detailed information was obtained from a number of private and state owned enterprises, which allowed to improve information on export of goods and

services within the BoP. Within the frames of information sharing with the State Customs Committee information on conditions for delivery of imported goods (advance payment, loan or letter of credit) was presented to the Central Bank which allowed to further clarify the trade credits and advances item of the other investment section of the BoP.

Taking into account recent macroeconomic trends, the Central Bank regularly updated forecast balance of payments in 2020, held regular consultations with relevant authorities on the forecast of the BoP, and sent necessary inquiries to a number of large state entities. A working group consisting of representatives of the Ministry of Economy and the State Customs Committee was established to prepare BoP forecasts, a part of country's economic and social development forecasts and initial forecast indicators of the BoP and their pass through to the FX market were assessed for 2021 and upcoming three years.

2.7 Development of country's consolidated foreign debt statistics and international investment balance, summary and dissemination of data

Efforts to collect and summarize data for country's consolidated foreign debt statistics and international investment balance continued over 9 months of 2020. Relevant authorities regularly delivered to the Central Bank government and government backed foreign debt statistics, and data on foreign debt by the oil-and-gas and non-public sectors.

Compliance of public, oil and gas and private sector loans (government and government guaranteed), securities (government and corporate) and payables and receivables (trade credits and advances) with the information provided by commercial banks on the ITRS was checked, and appropriate corrections were made. At the same time, the information obtained in cooperation with the State Customs Committee allowed to further clarify consolidated external debt statistics and the balance of international investments in the trade credits and advances item on both assets and liabilities.

Based on foreign debt data provided by the Ministry of Finance, government and government guaranteed foreign debt statistics was clarified. External debt statistics on the banking sector was assessed by the Central Bank on the basis of a digital balance sheet obtained from commercial banks. As a result, data on the country's consolidated foreign debt statistics were summarized and submitted to relevant public authorities.

Also, to improve the process of collecting and summarizing data of consolidated foreign debt statistics and the balance of international investments, efforts started on development of a new reporting form and guidelines, taking into account feedback and suggestions of relevant institutions (the Azerbaijan Banks Association, the Azerbaijan Insurers Association, etc.).

2.8 Maintaining banking sector rehabilitation and resilience

According to the information as of the end reported year, 26 banks are operating in the country, 2 out of which are state owned banks. The number of banks with foreign capital is 12, and the number of local branches of foreign banks is 2. Banks provide services via 447 branches, 2 715 ATMs, and 18 708 employees.

In 2020 banks' restructuring continued in accordance with the 'Strategic Roadmap on development of financial services in the Republic of Azerbaijan'. Sector's capital adequacy exceeds the regulatory requirement by more than 2 times.

In the reported year the Central Bank revoked licenses of 4 banks whose capital position was negatively zoned with no recovery potential (the AtaBank POJSC, the AmrahBank OJSC, the AGBank OJSC and the NBCBank OJSC) and the banks were declared bankrupt by a court decision. The Deposit Insurance Fund continue paying compensations to insured depositors of the closed banks from 1 June onward through the Capital Bank OJSC and the International Bank of Azerbaijan OJSC, selected as agent banks. According to the Fund, as of 31.12.2020 AZN616.1M worth compensation was paid to 24.2 thousand depositors on 4 banks whose licenses were revoked in 2020.

Also, quality of banks' assets was assessed over the reported period. Assessment findings were widely discussed with banks' management, relevant assignments were given.

Measures to rehabilitate and capitalize the banking sector were continued to support lending. In general, banks increased AZN131.7M worth share capital in 2020.

To mitigate negative translation of the pandemic to the financial sector as part of the implementation of relevant decrees of the President of the Republic of Azerbaijan and the Cabinet of Ministers the Central Bank approved additional support measures package to the financial sector on 24 April 2020 and adopted the 'Procedure for temporary regulation of activities of credit institutions on the backdrop of the coronavirus (COVID – 19) pandemic'. The approved procedure provides for support for individuals as well as pandemic affected entrepreneurs; reduction of banks' regulatory burden; increase of access of certain economic areas to credit resources; decrease of payment service expenses of economic agents in the context of the pandemic; maintenance of uninterrupted supply of insurance services and measures to protect the rights of the insured; and regulatory relief to capital market participants: a) banks were recommended to restructure loans of pandemic affected individuals and private entrepreneurs covered with state support mechanisms; b) to stimulate banks to issue mortgage loans with their own funds risk weights on the loans under this category was shifted to 50% from 100%; c) banks were recommended not to charge interest fine, penalties and other payments from legal entities and individuals in the event of delay in payment of credit liabilities; d) banks were allowed not to deteriorate classification of the loans restructured due to the pandemic and provisioning requirements were relaxed; e) the risk rate of micro loans issued under the guarantee of the Agrarian Credit and Development Agency under the Ministry of Agriculture was reduced; e) dividend payments on financial results of previous years were contained to further strengthen financial resilience of banks and insurance companies against macroeconomic shocks; f) the risk rate on loans issued to producers of medical supplies and equipment was reduced.

The following measures were taken to relax banks' regulatory burden: a) banks' aggregate capital adequacy ratio was reduced; b) counter-cyclic capital buffer was set at 0%; c) consideration of market and operational risks was ignored when calculating banks' capital adequacy indicators; d) consideration of the risks based upon debt burden on

consumer loans, maturity and interest indicators in calculation of the capital adequacy ratio was stopped until 1 January 2021; d) comprehensive inspections were postponed until 30 September 2020 in insurance companies and until 1 January 2021 in banks and investment companies; e) start of introduction of new regulatory requirements in banks was deferred.

To note, given ongoing threats triggered by the pandemic on financial sector resilience the period of application of main decisions and recommendations included in the package of supportive measures was changed twice and extended until 1 April 2021.

In 2020 banks restructured AZN1.2B worth about 52 thousand loans due to the pandemic and the process still continues. Business loans account for 87%, consumer loans for 9% and mortgage loans for 4% of restructured loans in terms of amount. Efforts to expand financial intermediation of the banking sector and make lending more accessible continued.

Synchronized measures by the government and the regulator allowed to prevent dramatic slump in lending activity. Banks' lending portfolio amounted to AZN14.2B skipping closed banks. Skipping closed banks, banks' mortgage portfolio increased by 13%, business loans remained stable and consumer loans decreased by 6.3%. Business loans account for 60% (AZN8.5B), consumer loans for 26% (AZN3.7B) and mortgage loans for 14% (AZN2 B) of the lending portfolio.

De-dollarization of loans continued. Over the year dollarization of the lending portfolio decreased by 5.6 pp to 30.2%. Currently, 46% of business loans, 7.4% of consumer loans and 0.8% of mortgage loans are denominated in a foreign currency.

Banking sector's liquid assets account for 32.9% of total assets (AZN10.5B). The instant liquidity ratio makes 60.9% (2 times (30%) more than the minimum requirement).

Banking sector's total liabilities decreased by 2.8% (AZN0.8B) to AZN27.4B (if to skip closed banks, in 2020 banks' total liabilities increased by 1.7%). Deposits account for 74% of total liabilities (40% (AZN8.2B) savings of the population). Drop in the size of deposits (8%) relates to the banks removed from the sector. If to skip closed banks, savings of the population increased by 2.9%. 83% of savings of the population was protected by the Deposit Insurance Fund. Despite removal of 4 banks from the sector and the pandemic, the deposit portfolio remained stable, which is an indicator of confidence in the banking sector, if to exclude structural factors. The stable exchange rate of the manat positively translated to de-dollarization of deposits. If to skip closed banks, dollarization of deposits decreased by 1.4 pp to 51.3% in 2020.

An initial framework was set at a technical support by the International Finance Corporation to create an agent banking institute to deepen financial intermediation. The work on supply of financial services in regions by selected pilot banks through the service points of Azerpost LLC entered the final phase.

Efforts continued to determine new regulatory requirements up to international standards to improve a regulatory framework on the banking sector, manage risks in banks, and strengthen stress testing, banks received necessary methodological support. Regulatory requirements were determined on management of liquidity, market and

operational risks in banks, relevant draft normative documents were developed. Application of the regulations was cancelled until 2021 not to create additional regulatory burden for banks amid the pandemic.

Works continued to adjust the legislative base on financial markets supervision to international best practices and standards as well. Due to transfer of the financial sector regulation and supervision function to the Central Bank, adjustments were made to the Law on the Central Bank of the Republic of Azerbaijan and other legislative acts and 4 new draft laws on insurance, payment systems, lease and pawnshop activity, draft amendments to existing legislative acts were developed and presented accordingly.

2.9 Maintaining development and resilience of the insurance sector

The Bank continued to ensure effective regulation and supervision in the insurance sector. A license issued to one insurer for insuring activity was revoked due to failure to meet minimum capital requirements on insurance activity within capitalization measures. In general, in 2020 insurance premium y/y increased by 7%, the main part of which is on life insurance products. Growth on life insurance companies was 14% and 3% on non-life insurance companies.

To improve insurance supervision a project developed with the World Bank on transition to risk-based supervision started to be implemented. Non-differentiation of insurers' capital requirements based on their risks according to the current legislation increases the risks of the sector and threatens financial stability. At the same time, reserves are created only based upon prudential norms, that impedes creation of adequate reserves in line with accepted risks. Implementation of the project will allow to properly and timely identify risks, effectively manage supervisory resources, and boost insurers' transparency level and investment related requirements.

At the same time, to strengthen insurance control, works are under way to improve e-insurance control system. To carry out compulsory real estate insurance electronically, a draft legislation was prepared and submitted to relevant authorities. The Bank started activity on improving the legislation on compulsory third party liability insurance of motor vehicles, compulsory insurance against occupational accidents and occupational diseases, and other insurance legislation. To this end, existing gaps were identified and opinions and proposals based on international experience are being prepared to address them.

A project was launched to educate the population and businesses on insurance. A large-scale and multifaceted awareness campaign will be conducted based on surveys to measure the awareness level. In addition, awareness-raising interviews, competitions and meetings organized by the Central Bank were held at different times to promote compulsory real estate insurance.

Works to improve the agro insurance mechanism continued in 2020 too. To train experts on risk and loss assessment in this area, the Cabinet of Ministers approved the 'Rules on examination of independent experts on agricultural insurance activities' with its Resolution No. 106 of 23 March 2020. Also, as the next step towards state support and

establishment of a progressive insurance mechanism for farmers, the 'Rules on Agrarian Insurance' were developed and approved by Decree No. 431 of the Cabinet of Ministers on 30 October 2020.

At the same time, minimum amount of capital was determined for 'a joint insurer operating the agrarian insurance system on behalf of the agrarian insurance body' with Decision No. 08/2 of the Management Board of the Central Bank dated 4 March 2020 on setting the 'minimum amount of required capital of the insurer' and the Joint Agrarian Insurance Company' OJSC, that manages the agrarian insurance system on behalf of the Agrarian Insurance Fund, was licensed to conduct joint insurance activities on 6 October 2020. The company, established from a legal and organizational point of view, signed the first agrarian insurance contract as a pilot. At present, the Agrarian Insurance Fund provides relevant insurance services to farmers through the Joint Agrarian Insurance Company.

Pursuant to the Law of the Republic of Azerbaijan 'on State Compulsory Personal Insurance of Military Servicemen', the Central Bank took control on the spot to ensure prompt execution of compulsory insurance payments to heirs of servicemen killed and those wounded during the Patriotic War. Settlement operations with banks with a wide branch network were provided for prompt receipt of payments by citizens. As a result, from the beginning of the Patriotic War until the end of 2020, 6110 persons received AZN22.3M worth insurance payment. 1347 of them are heirs of martyrs, 4763 are injured. To note, according to the law, heirs of martyred servicemen are paid AZN11000, Group I disabled persons AZN8800, Group II disabled persons AZN6600, Group III disabled persons AZN4400, those severely and lightly injured AZN 2750 and AZN550 respectively.

The Central Bank launched a working group to make insurance payments prompt. The group cooperates with relevant public authorities – the Ministry of Justice, the Ministry of Labor and Social Protection of the Population and the Ministry of Defense for prompt delivery of confirmation documents established by law to servicemen and their heirs.

2.10 Maintaining capital market development and resilience

A dedicated program was elaborated to make development, regulation and supervision of capital markets more effective and efforts continued under the program. To broaden opportunities for issuers and investors to participate in the capital market, the Central Bank approved 'Service fees of the National Depository Center' with due coordination on 01.12.2020. The new tariff policy promotes access of regulated segment of the capital market and companies to listing on the stock exchange and stimulates operations on registration of secondary market, market maker and repo deals with corporate securities on the stock exchange. The incentive tariff regime will contribute to the increase in financing of companies from the capital market through public offering, boost transparency in the market and expand opportunities for investors to participate in the capital market.

The legal framework for expanding financing opportunities by issuing bonds in the securities market was improved. To increase access of foreign investors to the capital market of our country, the Central Bank joined the associate membership of the IOSCO,

which sets international standards in the securities market, and began close cooperation with this organization for preferential membership.

Proposals to amend the Law on the Securities Market to improve the legal framework of the capital market were prepared. These proposals include direct participation of banks in the capital market, simplification of the process of issuing bonds by international financial institutions, creation of opportunities for transactions with government securities and notes on a trading platform determined by the Central Bank and promotion of investment funds. The Bank closely cooperated with the European Bank for Reconstruction and Development to improve the legal framework of the capital market.

Listing rules of the Baku Stock Exchange were improved under international requirements. To bring listing segments in line with international practice, two – stock and bond listing segments (basic and standard market) were identified, the alternative market segment was liquidated, and issuers without a listing agreement with the Baku Stock Exchange and whose securities were not actively traded were removed from the list. At the same time, the Baku Stock Exchange became a member of the World Federation of Exchanges in February 2020.

The Central Bank adopted an actions plan to support capital market participants during the pandemic. Capital market participants were provided with regulatory relief, as well as tariff concessions that support participation of issuers and investors in the market.

Amid the negative effect of the pandemic on the economy total trade turnover of the securities market amounted to AZN14.1B, aided by significant hike in secondary market deals and repo transactions. Moreover, in 2020 AZN12.2B worth investment securities were registered and 11 emission prospectus were approved.

The size of operations in the stock segment of the corporate securities market increased by 37% to AZN583M. The size of operations in the corporate bonds market, another segment of the corporate securities market, made AZN2 773M. Over the reported period USD20M worth shares of the AzerGold CJSC, USD35M worth bonds of the Kapital Bank OJSC, AZN2M worth bonds of the BTB Bank OJSC, AZN1.5M worth bonds of the Embafinans CJSC, AZN2.5M worth bonds of the Ferrum Kapital LLC, AZN1.4M worth bonds of the Hermes Finance CJSC, AZN251M worth bonds of the Mortgage and Credit Guarantee Fund, AZN30M worth shares of the Yelo Bank OJSC and AZN20M worth shares of the Kapital Bank OJSC were placed in the stock exchange market and included to the listing.

The size of transactions in the government securities market amounted to AZN8.6B. 46 auctions were held at the stock exchange on placement of Central Bank notes, the size of secondary market deals with notes increased by 30% to AZN491M. Total size of transactions with government bonds increased by 42% to AZN1.7B. 36 auctions on placement of government bonds and one closed placement were held at the stock exchange, as a result the size of primary market deals y/y increased by 77% to AZN1.2B. The secondary market of government bonds made AZN521M. At the same time, in 2020 for the first time, in line with the progressive international practice, issuers were enabled to increase supply if demand exceeded supply during government bond auctions. This both

increased the ability to flexibly meet demand for government bonds, and expanded opportunities for market financing.

The size of repo operations y/y increased by 92% (AZN1 028M) to AZN2 150M. 90% of repo operations were operations with government bonds. In 2020 for the first time there were repo deals with shares (AZN0.5M).

AZN12.2B worth investment securities were state registered in 2020 – 41 issues of corporate bonds AZN1 291M (11%), 119 issues of shares AZN766M (6%) and AZN10 115M worth (83%) issue of government securities. AZN7 190M worth government securities relate to short-term issue of Central Bank notes and AZN2 925M to registration of the issue of government bonds.

2.11 Protection of rights of consumers and investors in financial markets and financial literacy

On the basis of appeals received by the Central Bank in 2020, necessary measures were taken to prevent violations of the rights of consumers and investors in financial services and ensure restoration of violated rights, as well as formation and spread of modern knowledge and skills in finance was effectively organized.

Total 18133 appeals were received from consumers and investors in 2020: 15655 appeals relate to the banking sector, 2262 appeals to the insurance sector and 216 to the capital markets. As a result of investigation of complaints from consumers and investors, total 372 mandatory instructions were issued to supervised entities – the banking sector 186, the insurance sector 117 and the capital markets sector 69 instructions.

As a result of the measures taken, a part of the amount of compensation calculated in accordance with the Decree dated 28 February 2019 ‘on additional measures to address problem loans of individuals in the Republic of Azerbaijan’ – related actions were taken on return of AZN92.8 thousand worth funds to 59 citizens, unpledging real estate and movable property on appeals of 19 citizens, and violated depository rights of 392 citizens who applied to the Central Bank were restored. At the same time, necessary measures were taken to change information incorrectly submitted to the Centralized Credit Registry at the request of 35 citizens. Moreover, total AZN1M worth insurance compensation was paid to victims. In the capital markets sector, protocols on 43 administrative violations were drawn up.

The following measures were taken to ensure that consumers have access to information on questions and problems they encounter in financial services, as well as make inquiries and complaints:

- Information boards about the ‘966’ hotline were placed in administrative buildings (branches, departments) of banks and insurance companies operating in the territory of the Republic, in the places where citizens could see them.
- Letters were sent to organizations on addition of the ‘966’ hotline in contracts of banks, non-bank credit institutions and insurance companies.
- A system has been set up to record incoming calls, citizen information and directions of appeals to the information center.
- The process of official registration of citizens' verbal appeals to the hotline has begun.

- A Q-net Queue Management System was put into operation.
- During the quarantine period, online meetings were held with citizens via Skype

Over the period, 51215 calls to the '966' hotline were answered promptly. Meetings were held with 2617 citizens who applied to the Central Bank for protection of their rights, along with taking necessary measures to protect their rights, legal awareness work was carried out. During the quarantine period, online meetings were held with citizens via Skype

The Central Bank took a number of important measures in financial literacy. Products designed to increase society's financial literacy focus on important target groups, including children, adolescents, students, teachers, and the elderly.

The Bank continued a series of measures related to the implementation of the 'Increasing financial market participants' knowledge and skills target' of the 'Strategic Roadmap on development of financial services in the Republic of Azerbaijan' and the 'Strengthening literacy on and promotion of digital payments' direction of the 'State Program on expansion of digital payments in the Republic of Azerbaijan for 2018-2020'.

The Bank participated in evaluation and awarding of the poster competition joined by 180 students supported by the Ministry of Education, the Youth Foundation together with the Azerbaijan Youth Achievement Public Union within the framework of the 'Smart Budget' project. The contest titled 'Digital payments through the eyes of schoolchildren' was organized on Facebook, covering 163 people, and the winners were awarded with appropriate prizes. 26 online webinars for 1143 participants were organized for students and teachers of higher and secondary special education institutions.

On the basis of the decision of the Financial Stability Board dated 20 September 2019, the Azerbaijan Bank Training Center and the Center for Economic Reforms Analysis and Communication conducted awareness-raising activities and online trainings to prevent over-indebtedness of the population and an online course on related 5 topics was developed and put into operation.

Online trainings were held on digital payments and responsible lending for Methodists of Education Departments, DOST Agency and ASAN volunteers, employees of the Ministry of Transport, Communications and High Technologies, as well as employees of the Regional Development Public Union, Azerbaijan Youth Achievement Public Union, the Academy of the State Customs Committee, SME entities and staff of the Academy of the Ministry of Emergency Situations. A World Bank expert conducted a webinar on 'Best Practices for Customer Complaints in Financial Institutions'.

Special attention was paid to promotion on financial literacy in mass media and social networks, and enlightening messages were broadcast. The ITV channel provided information on financial literacy measures for children, as well as the 'Business Azerbaijan' program, the 'Bank Time' of the ARB channel and the 'Economic News' on the AzTV provided information on financial literacy events. The ASAN radio broadcasted a '1 question, 1 answer' feature on financial literacy topics, including benefits of cashless payments, payment cards, e-banking. As part of the 'Financial Literacy Month' in November the topics Financial Literacy, Capital Markets, Digital Payments and Insurance were discussed in the 'Guest' project on the ASAN radio. As part of a joint project with the Azerbaijan Bank Training

Center and the Center for Economic Reforms Analysis and Communication, Yüz Production presented an educational social video aimed at preventing the population from over-indebtedness. Animations on the Central Bank's Financial Literacy Portal (bizimpullar.az), as well as courses and innovations on the Virtual Education Platform (edu.e-cbar.az) are regularly shared on the Facebook page.

The content of the financial literacy portal was enriched, 10 new animations were uploaded, a link to the portal was prepared and posted on websites of all commercial banks. The content of the virtual education platform was also enriched, 6 new distance learning courses were developed and made public. Over the year, 50 exams were organized, 42 of them were successfully completed and relevant certificates were prepared and presented. Products and services of the 'Azerpost' LLC, as well as of NBCIs were added to the information-search system of financial products and services (infobank.az)

The Central Bank developed a 'Bank-loto' educational board game, info graphics on the 'Government Payment Portal', '10 Golden rules in card use', 'Benefits of digital payments', 'Card-to-card service', 'Advantages of digital payments in the context of the pandemic', as well as brochures on 'Consumer loans: specifics of payments', 'Easy loan: whether to take or not', 'Guarantor Rights and Obligations' and 'Credit Potential Calculation' to increase knowledge and skills on financial products and services.

2.12 Regulation of deposit insurance

The Central Bank evaluated the effect of continuation of the blanket guarantee on the banking sector due expiry of the full deposit insurance period, simulations were conducted on various models of setting insurance limits. Decisions were made to withdraw from the full deposit insurance scheme and move to a new model by determining the transition period. The new model envisages setting a limit on the compensation amount and expansion of the coverage of insured depositors. As a result of these changes, deposits of 99.9% of total depositors in terms of the number were fully protected. At the same time, expansion of the coverage of insured depositors is aimed at supporting the policy of small business development and increasing confidence in the banking system, as well as further strengthening the protection of the rights of consumers of financial services.