

Regulation on related party transactions in banks

1. General provisions

1.1. This Regulation has been developed in accordance with Articles 34.2.7, 34.2.8, 34.2.14 and 40.1.1-1 of the *Law of the Republic of Azerbaijan ‘on Banks’* and establish minimum requirements for related party transactions of banks, as well as local branches of foreign banks (hereinafter – banks).

1.2. Considering the minimum requirements set forth in this Regulation, banks should have adequate policies and procedures on related party transactions in place for safe banking activities.

1.3. When conducting related party transactions, the requirements of the *Civil Code* and the *‘Law on Banks’ of the Republic of Azerbaijan* should also be adhered.

1.4. *The Central Bank reserves the right to make a substantiated judgment regarding the identification of related parties, in accordance with Article 53-3.2.2 of the Law of the Republic of Azerbaijan on the Central Bank.*

2. Definitions

2.1. The definitions used in this Regulation bear the following meanings:

2.1.1. related parties of banks (hereinafter – related party) - persons specified in Article 49-1.1 of the *Civil Code of the Republic of Azerbaijan, including heads of bank’s structural units*, any person that has a direct or indirect share, that enables to significantly influence the bank’s decision-making under a contract regardless of the share in bank’s authorized capital, members of the bank’s Audit Committee, staff of an internal audit division, other bank staff participating in decision-making, the bank’s chief accountant (the person performing these duties), persons who have kinship ties with those persons, as specified by Article 49-1.1.3 of the *Civil Code of the Republic of Azerbaijan*, persons entitled to act on behalf of a related party, legal entities in which the persons specified under Articles 49-1.1.6 and 49-1.1.7 of the *Civil Code of the Republic of Azerbaijan* have at least 20 percent participation share, and persons with whom transactions considerably different from market conditions without any obvious economic grounds are conducted. The head and the chief accountant of a local branch of a foreign bank (the person performing these duties), as well as other persons related to the foreign bank according to the legislation of the foreign bank’s home country are deemed related parties of a local branch of a foreign bank.

2.1.2. significant related party loan – loan exposure granted to one related party, total amount of which is 1 (one) percent and over of bank's Tier I capital after deductions.

2.1.3. partially significant related party loan – loan exposure granted to one related party, total amount of which is up to 1 (one) percent of bank's Tier I capital after deductions considering the requirements of sub-item 3.5.4. of this Regulation.

2.1.4. non-standard asset – the asset classified as non-standard under regulations of the Central Bank of the Republic of Azerbaijan (hereinafter – the Central Bank).

2.2. if the size of indirect participation of one person arising via direct ownership of another person's stocks or shares (in relations after the third person) is less than 10 (ten) percent, such participation is not considered in identifying related parties for the purposes of this Regulation. (e.g., if the 'A' has 45% share in the 'B', the 'B' has 60% share in the 'C', and the 'C' has 30% share in the 'D' ($45\% \times 60\% \times 30\% = 8.1\%$) the 'A' is not considered to have indirect participation in the 'D').

2.2-1. *For the purposes of this Regulation, a bank's structural unit is defined as its branch, division, and representative office, as specified in the Law of the Republic of Azerbaijan on Banks. Additionally, another bank employee involved in decision-making is defined as a special category employee, as specified in sub-items 2.1.15.1 and 2.1.15.2 of the 'Corporate Governance Standards in Banks,' approved by Decision No. 41/1 of the Central Bank's Management Board on 28 August 2023.*

2.3. According to this Regulation, outstanding amount of credit exposures is considered when calculating their total amount. Definitions 'credit exposure, bank acceptance' and 'qualifying holding' used in this Regulation bear the meanings specified in the 'Regulation on prudential ratios and requirements related to credit risks, including large credit risk exposures' approved by Decision No. 29/1-2 of the Management Board of the Central Bank dated 22 July 2022.

2.4. The scope of groups of collateral used in this Regulation is determined under the 'Regulation on creation of special reserves for asset classification and loan loss provisioning' approved by Decision No 29/1-1 of the Management Board of the Central Bank dated 22 July 2022.

2.5. *When a related party bears joint or subsidiary responsibility for a bank borrower's obligation, or when the related party's asset is used to secure the obligation of the bank's borrower, that obligation (specifically the portion for which the related party bears responsibility or that is secured by the related party's asset) is considered a credit claim against the related party for the purposes of this Regulation.*

2.6. *This Regulation does not apply to mortgage loans issued from the funds of the Mortgage and Credit Guarantee Fund of the Republic of Azerbaijan (except in cases where the bank repossesses the right to claim on the mortgage loan).*

2.7. *This Regulation does not apply to the claims of state-owned banks to state-owned legal entities (except for claims and transactions involving legal entities with a qualifying holding in the bank) and transactions with them.*

3. Norms and requirements regarding credit risks on related parties

3.1. It is prohibited to grant concessional loans to related parties or conduct other operations under concessional terms different from those offered to other customers. For the purposes of this Regulation, the term 'concession' is defined as providing more

favorable conditions than the average conditions (*maturity, interest rate, etc.*) applied to transactions (products) of *the same type and currency* conducted with other customers of the same category during the past 30 (*thirty*) days.

3.2. It is prohibited to transfer (pass/buy) non-standard assets, as well as acquire assessment and auditor services from related parties.

3.3. Total amount of credit exposures against related parties should not exceed the following limits (except for the cases where a lower limit is set in bank's internal rules):

3.3.1. per legal entity – 10 (ten) percent of bank's total regulatory capital.

3.3.2. per individual – 3 (three) percent of bank's total regulatory capital.

3.3.3. on all related parties – 20 (twenty) percent of bank's total regulatory capital.

3.4. The bank may not issue a significant related party loan without collateral. In this case, ~~only Group 1~~ collateral meeting the following requirements should act as collateral:

3.4.1. when cash in the same currency as the loan is used as collateral, the face value of that collateral should be no less than 100 (one hundred) percent of the credit exposure.

3.4.2. when collateral from Group 1, other than that specified in sub-item 3.4.1 of this Regulation, is used to secure the loan, the market value of that collateral (nominal value in relation to cash, guarantees, and warranties) should be no less than 125 (one hundred and twenty-five) percent of the credit exposure.

3.4.3. *when collateral from the second, third, or fourth groups is used for loan securitization, the market value of that collateral (or the nominal value in the case of a guarantee or warranty) should not be less than 200 (two hundred) percent of the loan exposure.*

3.5. The bank may issue partially significant related party loans under the following conditions:

3.5.1. when cash in the same currency as the loan is used as collateral, the face value of that collateral should be no less than 100 (one hundred) percent of the credit exposure.

3.5.2. when collateral from the first group, other than that specified in sub-item 3.5.1 of this Regulation, is used to secure the loan, the market value of that collateral (nominal value in relation to cash, guarantees, and warranties) should be no less than 125 (one hundred and twenty-five) percent of the credit exposure.

3.5.3. when the second, third and fourth groups of collateral acts as collateral for the loan, the market value of that collateral (face value in relation to the guarantee (warranty)) should be no less than 150 (one hundred and fifty) percent of the credit exposure.

3.5.4. when the market value of collateral (face value in relation to cash, guarantees and warranties) is lower than the limits specified in sub-items 3.5.1 - 3.5.3 of this Regulation, the fifth group of collateral acts as collateral for the loan, or the loan is unsecured, total amount of such credit exposures should not exceed 1 (one) percent of bank's Tier I capital after deductions.

3.6. *The following credit exposures are not considered (are excluded from the calculation) when calculating the ratios specified in Item 3.3 of this Regulation:*

3.6.1. *the unconditionally secured portion of a credit exposure when funds in the same currency as the loan are used as collateral.*

3.6.1-1. *when a credit granted in foreign currency is secured by cash denominated in a currency different from the credit currency, but only in euros, British pounds sterling, US dollars, Japanese yen, or Swiss francs, up to 80% of the unconditionally secured portion of such credit*

exposure for credits with a maturity of up to one year, and up to 70% for credits with a maturity of more than one year.

3.6.2. correspondent account balances (in the case of banks operating in the Republic of Azerbaijan, as well as banks with a minimum investment rating issued by international reputable rating agencies (Standard & Poor's, Fitch Ratings, Moody's)).

3.6.3. claims on intraday interbank transactions (overnight/intraday).

3.7. The following portions of off-balance sheet liabilities are included in the calculation of the norms specified in Item 3.3 of this Regulation:

3.7.1. 10 (ten) percent of obligations where the bank is contractually entitled to unilaterally not fulfill the full obligation.

3.7.2. 20 (twenty) percent of off-balance sheet liabilities with up to one year maturity.

3.7.3. 50 (fifty) percent of off-balance sheet liabilities with over one year maturity.

3.7.4. credit lines, bank acceptance and liabilities for the full amount of buy/sell of securities.

4. Decision-making procedures on related party transactions

4.1. Related party loans, constituting 5 (five) percent or more of bank's assets, are issued based on the independent auditor's opinion and the decision of the general meeting of shareholders with voting rights. Related party loans, constituting up to 5 (five) percent of bank's assets, are issued by the decision of the Supervisory Board or, in compliance with the requirements of Item 4.2 of this Regulation, by the Management Board, unless decision-making authority is delegated to the general meeting of shareholders.

4.2. Partially significant related party loans to other related parties, excluding bank's shareholders, members of the Supervisory Board, and the executive body, are granted by the decision of the bank's Management Board under the following *condition and limit*:

~~4.2.1. Total amount of credit exposures issued to one related party by the decision of the Management Board should not exceed 0.01 percent of bank's Tier I capital after deductions.~~

4.2.2. Total amount of credit exposures issued to all related parties by the decision of the Management Board should not exceed 1 percent of bank's Tier I capital after deductions. *Within this limit, the total amount of credit claims against a related party may be determined by the bank's Supervisory Board based on the decision of the Management Board.*

4.3. Decisions on granting loans to a related party should include information on all prior loans extended and loans to be extended to the related party (e.g., previously taken loans, their repayment status, the amount, currency, interest rate of the loan sought and/or the value of other payments, information on borrower's creditability, the value of collateral, etc.). Decisions are formalized with the relevant meeting minutes.

4.4. Members of Supervisory and Management Boards should inform any conflict of interests before deliberations commence, not participate in the discussion and decision-making processes, as well as their participation should not be factored into the calculation of the quorum when:

4.4.1. the matter of granting loans to him/herself and the persons with kinship specified in Article 49-1.1.3 of the Civil Code of the Republic of Azerbaijan is raised for discussion.

4.4.2. the matter of granting loans to any legal entity in which he/she has qualifying holding or significant influence is raised for discussion.

5. Elimination of violation of norms and requirements

5.1. If the bank detects a violation of the norms and requirements specified in this Regulation, the bank's Chief Risk Officer should inform the Central Bank about it no later than the next working day. The information provided should specify the reasons for the violation and outline the measures to be taken to eliminate it.

5.2. The bank should rectify any violations of the norms and requirements outlined in this Regulation within 60 (sixty) calendar days, stemming from a reduction in the level of total regulatory capital, the transformation of the borrower into a related party, or the loss of, or decrease in the market value of collateral.

6. Reporting and monitoring

6.1. The bank submits the report on related party transactions to the Central Bank together with prudential reports monthly as per Annex 1 to this Regulation.

6.2. The bank's internal audit unit assesses the compliance of bank's related party transactions with the requirements of this Regulation and bank's internal rules at least once a year, and findings of the assessment are presented to the bank's Audit Committee.

