'Approved'
Central Bank of
the Republic of Azerbaijan
Resolution № 29/1-1
22 July 2022

Regulation on asset classification and creation of specific reserves for loan loss provisioning

1. General provisions

1.1. This Regulation has been developed in accordance with Article 34.2.12 of the Law of the Republic of Azerbaijan on Banks (hereinafter – the Law), as well as considering the standards of the Basel Committee on Banking Supervision and determine procedures for creation of specific provisions to classify assets and cover possible asset losses in banks and local branches of foreign banks operating in Azerbaijan (hereinafter – banks).

1.2. This Regulation does not apply to educational student loans issued at the expense of the Educational Student Loan Fund operating under the Ministry of Education of the Republic of Azerbaijan (except for the cases where the bank has a financial liability).

2. Definitions

2.*1*. The definitions used herein bear the following meanings:

2.*1*.1. assets – loans granted by a bank, other assets allocated to be repaid, prepaid funds by a bank, assets not used in banking, investments in participation share of legal entities' capital, and off-balance sheet liabilities.

2.*1*.2. outstanding amount – unpaid portion of the loan's principal amount. The outstanding amount of the non-loan asset is its balance value.

2.*1*.3. total amount – total of outstanding amount of the asset and interests accrued on the outstanding amount, commission fee, delinquency charge, and other unpaid amounts.

2.*1*.4. market price – price for goods (work, service) from interaction of demand and supply.

2.*1*.5. liquid market – a market with sufficient sale and purchase offers, which makes the sale possible in due course and at a market price.

2.*1*.6. net market price- difference between the market price of an asset and all its sale related costs.

2.*1*.7. consumer loan – loans to individuals for purposes not related to entrepreneurship or professional activity, acquisition, and construction of real estate, *including credit lines*.

2.1.7-1. car loan - a consumer loan granted for the purpose of acquiring a vehicle, the subject of collateral of which is that vehicle.

2.1.7-2. vehicle – the vehicle purchased by individuals for personal consumption.

2.*1*.8. real estate loan – loans issued to individuals for acquisition or construction of real estate for personal consumption.

2.1.9. business loan – loans to legal entities and unincorporated individual entrepreneurs for entrepreneurial purposes, *as well as agriculture loans*.

2.1.9-1. agriculture loan – a business loan issued in national currency to micro, small, and medium-sized enterprises and family farms (hereinafter – agricultural entities) operating in the agricultural sector and meeting the following criteria to finance production costs of agricultural products (the purchase of agricultural production tools, mineral fertilizers, bio humus, seeds, and pesticides, as well as the use of agrochemical and agrotechnical services, etc.), the trading and processing of agricultural products, where at least three-fourths of the production belongs to the agricultural entity, as well as projects for the development of the agricultural sector (setting up orchards, construction of agricultural product storage facilities, and creation of livestock farms (including fisheries, poultry farming, etc.):

2.1.9-1.1. borrowers should register with the 'Electronic agriculture' information system (EAIS).

2.1.9-1.2. except for the borrowers who have family farming, other borrowers should have at least 3 (three) years of experience in agriculture.

2.1.9-1.3. borrowers who have family farms should have a certificate specified in Article 5.2 of the Law of the Republic of Azerbaijan 'on Family farming'.

2.1.9-2. agricultural production tools – agricultural machinery (e.g. tractors, soil preparation and cultivation machinery, sowing and planting machinery, harvesting and collection machinery, fertilizer spreaders and preparation equipment, etc.), technological equipment (including irrigation system sets and equipment), as well as breeding animals.

2.1.10. restructured asset – debt liability, contractual terms of which were changed, or which was documented as a new obligation with a view to implement the debt liability, due to debtor's financial difficulties. Financial difficulty of the borrower means that borrower's cash flows are not adequate for the performance of obligations under existing contractual terms, at least 20 (twenty) percent of total amount of the borrower's liabilities are delinquent for more than 90 (ninety) days based on the information of credit bureaus, or there is a probability of such situations to occur, etc. Changing of contractual terms means any of the following:

2.1.10.1. reduction of interest rate.

2.1.10.2. reduction of principal amount or accrued interest *and/or other payments specified in the agreement*.

2.1.10.3. prolongation of asset maturity.

2.1.10.4. granting new or additional grace period (non-repayment within a specified period or only interest payments *and/or other payments specified in the agreement*).

2.1.10.5. change of a repayment schedule of principal and interest *and/or other payments specified in the agreement*.

2.1.10.6. more favorable rights and advantages than existing contractual terms to the customer by a bank in addition to those specified in sub-items 2.0.10.1-2.0.10.5 herein.

2.1.11. overdue loan – a loan where payments against the principal amount or interest accrued, *and/or other payments specified in the agreement* or the outstanding portion of any of them, are delinquent for more than 30 calendar days beyond the contractual maturity date.

2.1.12. collateral – an asset pledged as collateral, mortgage, and other types of collateral to ensure performance of liabilities by the borrower or a third party.

2.*1*.13. specific provisions (hereinafter – reserves) – funds allocated to cover possible losses.

2.*1*.14. interbank claims - deposits placed by a bank with another bank, correspondent account balances and granted loans.

2.*1*.15. a group of joint borrowers – persons who act as mutual guarantors for repayment of the loan received by each member of the group under the agreement.

2.*1*.16. the loan-to-value ratio (LTV ratio) – the ratio of total amount of the loan (principal debt and accrued interest under the loan agreement *and/or other payments specified in the agreement*) to the market value of collateral.

2.*1*.17. the debt-to-income (DTI) ratio – the ratio of borrower's monthly debt burden on consumer loans to his/her income (on individuals in a group of joint borrowers the ratio of their total monthly debt burden to their total income).

2.*1*.18. debt burden - total amount of unpaid liabilities of the borrower (including credit lines) on loans taken from credit institutions, total amount of monthly repayments determined by the schedule (including credit lines) where he/she acted as a guarantor, as well as monthly repayments on leasing agreements and other debt liabilities on the basis of information from credit bureaus, except for deposit-backed liabilities (the LTV ratio not exceeding 100% in the national currency and 90% in a foreign currency).

2.*1*.19. monthly installment – equal monthly payment of the principal amount, accrued interest, *and/or other payments specified in the agreement* (credit, leasing, or other debt obligations), as defined in the agreement (annuity payments). In credit line agreements and the agreements that do not stipulate annuity payments (credit, leasing, and other debt obligations), the monthly installment is based on total amount of the obligation (credit limit for credit lines) and the remaining term of the agreement, following the annuity method.

2.*1*.20. borrower income – monthly income of an individual borrower ~~at least~~ for recent 6 (six) months approved with relevant documents (certificate of employment with salary, certificate of scholarship from an educational institution, certificate of payment of pensions and benefits to the borrower by social security authorities, bank reference confirming interest income on borrower's existing deposit accounts or other documents confirming his/her income), average monthly income for ~~at least~~ recent 12 (twelve) months for borrowers whose income is not related to hired labor (work performed on the basis of an employment contract in accordance with the labor legislation), *or the income forecasted under the behavioral model established in the 'Regulation on credit risk management in banks' approved by Resolution No 46/4 of the Management Board of the Central Bank*. Average monthly income of the borrower is calculated by dividing total income of previous 6 (six) months by 6 (by 12 for borrowers whose income is not related to hired labor). In the event relevant state bodies (institutions) are integrated to electronic information systems, relevant documents and information can be obtained by the bank from that information system in a real time.

2.*1*.21. non-hedged borrower – sensitive to exchange rate risk arising or likely to arise from any form of liability in a foreign currency.

2.*1*.22. multilateral development banks - an international financial institution established by two or more countries to support economic development.

2.*1*.23. fully secured asset – where its collateral falls under Groups 1 and 2 specified in Part 11 herein, the asset whose market value is not less than 100% (one hundred) of the amount of liability it secures, and in case of other collateral, not less than 150% (one hundred fifty).

2.*1*.24. partially secured or non-secured assets – the asset that fails to meet the requirements specified in sub-item 2.0.23 herein.

2.2. For the purposes of this Regulation, a credit line means the bank's obligation, under the bank account agreement, to extend credit (credit the account) for the execution of payments notwithstanding the absence of funds in the customer's account (excluding any obligations arising independently of the customer's intent to borrow or the credit institution's intent to lend, including but not limited to those resulting from exchange rate fluctuations or technical malfunctions occurring during clearing).

3. General requirements regarding asset classification

3.1. Banks classify and create reserves on their assets under this Regulation. Unless otherwise specified herein, the requirements specified in Part 3 apply to all assets. Internal procedures of banks set analysis criteria for asset quality and quality control, recording of assets classification, as well as procedures to write off loss assets from the balance sheet.

3.2. Assets are classified by a responsible structural division, designated by bank's internal procedures based upon the principle of avoiding the conflict of interests. The structural unit engaged in the issue of loans may not classify assets.

3.3. Assets are divided into standard and non-standard assets. Standard assets include satisfactory and watch assets, non-standard assets include non-satisfactory, doubtful and loss assets.

3.4. Assets are classified on the delinquency period and quality criteria separately considering the level of their securitization. If resulting from two classifications, classification categories for an asset differ, the lower category is used. Satisfactory assets are the highest and loss assets are the lowest category. Satisfactory assets are classified as high, while loss assets as low-quality assets.

3.5. Classification of assets by delinquencies:

3.5.1. Unless otherwise provided herein, classification category in terms of delinquency is determined in accordance with the following table:

Asset type	**Classification category**				
	Satisfactory	Watch	Non-satisfactory	Doubtful	Loss
Fully secured asset	0-30 days	31-90 days	91- 240 days	241-360 days	over 360 days
Partially secured or unsecured asset	0-30 days	31-90 days	91-180 days	181-270 days	over 270 days

3.5.2. asset's delinquency period (on principal and interest debts *and/or other payments specified in the agreement*) is calculated from the date set for repayment of principal and/or interest debts in the relevant agreement *and/or other payments specified in the agreement*.

3.5.3. in determining a secured asset, the part of the market value of Group 5 collateral herein that exceeds 25% of total amount of the loan request is not taken into account. *Project financing loans issued under the requirements of the 'Regulation on prudential regulation of project financing loans' (hereinafter – project financing loans) irrespective the level of securitization and* real estate loans issued in accordance with the LTV ratio defined in the 'Regulations on prudential norms and requirements regarding credit risks, including large credit risks' are considered fully secured assets.

3.6. Assets are classified in terms of quality criteria based on the below criteria. Detection of one or more of the criteria (cases) defined for each classification category gives grounds for assigning the asset to that classification category. When cases of different classification categories are found for the same asset based on the quality criteria, the lower classification category is taken as the basis. Classification under the category of 'standard assets exposed to additional risks' is carried out based on the quality criteria. If one or more of the criteria defined in sub-item 3.6.3 herein are found for a standard asset classified by the delinquency period, that asset is classified as a 'standard asset exposed to additional risks':

3.6.1. criteria for satisfactory assets:

3.6.1.1. borrower's creditability is acceptable for full and timely repayment of contractual liabilities.

3.6.2. criteria for watch assets:

3.6.2.1. there are risks likely to impact borrower's creditability (except for the risks specified in sub-items 3.6.3 – 3.6.6).

3.6.2.2. periodic reports specified in the agreement are not submitted (e.g. balance sheet, income statement).

3.6.2.3. a foreign currency denominated loan is issued to a non-hedged borrower.

3.6.3. criteria for standard assets exposed to additional risks:

3.6.3.1. negative cases occur in borrower's creditability due to deterioration of the economic situation (e.g., 2 times over 30-day delinquency over recent 6 months).

3.6.3.2. in case of necessity to attract funds from additional sources to repay the debt (e.g., sale of property, attraction of additional funds by the borrower) or pledge additional collateral.

3.6.3.3. the borrower has been operating at a loss for more than 1 (one) year, except for the cases where the borrower's business or strategic plan envisages operating at a loss for a certain period (here, 'the borrower operating at a loss' means that the borrower's profit before interest, taxes, and depreciation (EBITDA) is less than its total interest expenses or is negative).

3.6.4. criteria for non-satisfactory assets:

3.6.4.1. documents confirming use of the loan for its intended purpose are not submitted.

3.6.4.2. in case of significant delays in the schedule of work defined in the business or strategic plan (except for the cases when the documents justifying and confirming the change are submitted to the bank in the event of a change in the schedule of work defined in the business or strategic plan).

3.6.4.3. when one or more of other assets of one borrower or a group of related borrowers in the same bank, not referred to in sub-items 3.6.5.2 and 3.6.6.3 herein, are classified as non-standard assets. This criterion is applied when the sum of non-standard assets of a borrower

or a group of related borrowers is at least 20 (twenty) percent of total amount of his/her (their) liabilities.

3.6.4.4. in the event of bankruptcy of one of the companies with a qualifying holding in the group of related borrowers to which the borrower belongs.

3.6.4.5. interbank claims, as well as claims against borrowers with a minimum investment rating assigned by internationally reputable rating agencies (Standard & Poor's, Fitch Ratings, Moody's (hereinafter – international rating agencies), and except for agricultural loans, where, based on the terms of the agreement, the periodicity of payment of interest and/or other payments specified in the agreement is from one quarter to one year, and for assets specified in Section 8 herein, from six months to one year.

3.6.5. criteria for doubtful assets:

3.6.5.1. bankruptcy proceedings are initiated against the borrower.

3.6.5.2. one or more of other assets of a borrower or a group of related borrowers in the same bank are classified as non-standard assets. This criterion applies when the sum of doubtful assets of a borrower or a group of related borrowers is at least 20 (twenty) percent of his/her (their) total liabilities.

3.6.5.3. relevant documents required with respect to credit risk assessment in the list of documents and information to be included to the credit file in accordance with Annex 1 to the 'Regulations on credit risk management in banks' are not available.

3.6.5.4. except for project financing loans during the pre-operational phase, when, based on contractual terms, the periodicity of payment of interest and/or other payments specified in the contract exceeds one year.

3.6.6. criteria for loss assets:

3.6.6.1. the borrower is declared bankrupt, or his/her activity is terminated, as well as findings of monitoring by bank indicate that the borrower's activity has been suspended and that there are no sufficient financial sources for repayment of the debt.

3.6.6.2. the borrower dies, is considered dead or missing in accordance with the Civil Code of the Republic of Azerbaijan, or it is impossible to find the borrower who failed his/her liabilities (when search operations started on the person in accordance with the Law of the Republic of Azerbaijan on Search Operations). This criterion does not apply to assets whose principal debt and accrued interest liabilities, *and/or other payments specified in the agreement* are executed by the guarantor or any third party on time and in full. At that, repayments made with a deviation from the payment schedule up to 10 (ten) working days are considered as timely payments.

3.6.6.3. one or more of other assets of a borrower or a group of related borrowers in the same bank are classified as loss assets. This criterion is applied when the sum of loss assets of a borrower or a group of related borrowers is at least 20% (twenty) of total amount of his/her (their) liabilities.

3.6-1. The quality criteria under the assets 'exposed to additional risks' category do not apply to agriculture loans. If one or more of the criteria specified in sub-item 3.6.3 herein are met for an agriculture loan that does not fall under the non-standard asset classification category, such a loan is classified as a watch asset.

3.7. The analysis of quality criteria is documented. At that, findings of internal models adopted by Supervisory Boards of banks, as well as findings obtained from monitoring reports

are also included in the documentation of the analysis. Where the documentation is maintained electronically, the requirements of the Law of the Republic of Azerbaijan on Electronic Signature and Electronic Document should be observed.

3.8. Non-standard asset's classification category can be upgraded to a watch asset if:

3.8.1. overdue principal and interest debt, *and/or all payments specified in the agreement* on the asset is repaid in full (excluding repayments at the expense of collateral).

3.8.2. the borrower does not have another overdue loan, which makes up more than 20% of his/her total liabilities based on credit bureau information.

3.8.3. it is compliant with the quality criteria specified for satisfactory or watch assets specified in sub-items 3.6.1 and 3.6.2.

3.8.4. at least 3 (three) consecutive annuity payments are made in full and on time.

3.9. To classify a non-standard asset as a satisfactory asset, in addition to the requirements set in sub-items 3.8.1 and 3.8.2 herein, at least 6 (six) consecutive annuity payments should be made in full and on time, as well as the requirements of sub-item 3.6.1 herein should be met

3.10. The classification category of the assets written-off from and recovered to the balance sheet is improved as per Items 6.3 and 6.4 herein.

3.11. Repayments with a deviation of up to 10 (ten) days from the repayment schedule on sub-item 3.8.4 and Item 3.9 herein are considered as timely repayments.

3.12. A loan granted based on a behavioral model is classified as at least a 'standard asset exposed to additional risks' at the time it is issued.

4. Creation of reserves and loss asset charge off

4.1. Reserves are created for possible asset loss provisioning and are divided into two categories:

4.1.1. general reserves created to cover possible losses on bank's standard assets.

4.1.2. specific reserves created to cover possible losses on bank's non-standard assets.

4.2. Unless otherwise provided herein, the rates of reserves by classification categories are determined in accordance with the following table:

Classification category	*Consumer loans*		*Business loans*			*Other assets, including real estate loans, except for consumer and business loans*
	National currency	*Foreign currency*	*National currency*	*Foreign currency*	*Agriculture loans in national currency*	
Satisfactory assets	*1%*	*2%*	*1%*	*2%*	*1%*	*1%*
Watch assets	*5%*	*10%*	*2%*	*3%*	*2%*	*2%*
Standard assets exposed to additional risks	*15%*	*20%*	*10%*	*12%*	-	*10%*

Non-satisfactory assets	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*
Doubtful assets	*50%*	*50%*	*50%*	*50%*	*50%*	*50%*
Loss assets	*100%*	*100%*	*100%*	*100%*	*100%*	*100%*

4.3. For prudential reporting purposes, provisions are created in the national currency for the total amount of the asset at the expense of the bank's expenses.

4.4. If the principal amount or interest payments, *and/or other payments specified in the agreement* on the asset are delinquent for over 90 days, reserves are created to 100% of accrued *payments*.

4.5. Reserves are created per asset or, through assessment of risks inherent to an asset group, on this group (loans, interbank claims, securities, payables, other assets). Created reserves are used to cover possible losses on all assets of that group.

4.6. Loss asset is charged off from the balance sheet in the amount of the reserve created on that asset.

4.7. The bank charges off loss assets from the balance sheet at the decision of the Supervisory Board based upon the petition of the Management Board. Except for the loans issued to related parties, the Supervisory Board may delegate the authority of charging of loss assets with total amount up to AZN20,000 (twenty thousand) in national and foreign currencies, as well as loss assets specified in Part 9 herein to the Management Board. At that, total amount of assets charged off from the balance sheet during a calendar year at the decision of the Management Board should not exceed 1% of Tier I Capital of the bank as of the end of the previous year except for the loss assets specified in Part 9 herein. A report on the assets charged off from the balance sheet at the decision of the Management Board should be submitted to Supervisory Board members until its next meeting. All assets charged off from the balance against reserves and outstanding interests on these assets are recorded and maintained in relevant off-balance sheet accounts (sub-accounts) for at least 5 (five) years. When creating reserves for loss assets, the discounts specified in Part 11 herein do not apply to assets written off and subsequently returned to the balance sheet.

4.8. No provision is made on correspondent accounts with the Central Bank of the Republic of Azerbaijan (hereinafter – the Central Bank) and the banks with the minimum investment rating issued by international rating agencies *and overnight deposits (a deposit placed for one day)*, as well as on other claims with no delinquency due to the Central Bank and banks with a minimum "A-" credit rating (or equivalent).

4.9. Created reserves are assessed in terms of adequacy to asset quality by the structural unit, that carry out the classification, at least once a month, no later than the last business day of a month. The quality criteria are assessed at least once every 6 (six) months for borrowers with total residual debt of more than 3% (three) of Tier I Capital in the same bank, and at least once a year for other borrowers, unless otherwise provided herein. *For agriculture loans, if the periodicity of interest payments and/or other payments specified in the agreement is up to 1 (one) year, an on-site assessment by a bank employee should be conducted at least once every 6 (six) months (if the loan maturity is less than 6 (six) months), at least once during the loan term). If the periodicity is one year or more, the assessment should be conducted at least once during half of the periodicity (for example, if the periodicity is 18 (eighteen) months, at least once every 9 (nine) months).*

4.10. For the purposes of prudential reporting the following is taken into account:

4.10.1. if monthly asset evaluation identifies quality improvements, reserves already created, and funds received by the bank later, on repayment of assets previously charged off from the balance sheet are channeled to reduce the relevant expenses account, and charged to income if the expense account has no balance left.

4.10.2. the amount of specific reserves created for any asset is deducted from that asset's amount. The amount of general reserves created for an asset is recorded as a separate item under the 'Capital' accounts.

4.10.3. the reserve account may not have a debit balance. If assets to be charged-off against reserves exceed the balance of the reserve account, the required amount is provided from the everyday operating cost. Reserves may not be funded from the 'Retained Earnings' or other capital accounts.

5. Classification of consumer loans

5.1. Consumer loans are classified in terms of delinquency as follows:

Classification category	Satisfactory	Watch	Non-satisfactory	Doubtful	Loss
Delinquency period	0-30 days	31-90 days	91- 120 days	121 - 150 days	over 150 days

5.2. Consumer loans are classified as non-satisfactory when issued or its limit is increased if:

5.2.1. the borrower has an overdue loan over recent 6 (six) months based on credit bureau information.

5.2.2. the periodicity of interest payment under contractual terms, *and/or other payments specified in the agreement* is more than 90 days (except for loans issued under life insurance).

5.2.3. except for the following cases, the difference between total income of the borrower or the members of the group of joint borrowers and their debt burden calculated as per Annex 1 herein is lower than the country's minimum cost of living and/or the DTI ratio calculated as per Annex 2 herein is over 45%:

5.2.3.1. the LTV ratio is not over 90% in case foreign currency denominated deposits in the same bank (belonging to the borrower or a third party) or bank metals pledged (held) to the bank act as collateral for consumer loans in foreign currency.

5.2.3.2. where deposits in the same bank (belonging to the borrower or a third party) act as collateral of national currency denominated consumer loans the LTV ratio is not over 100% and if the LTV ratio is not over 90%, when bank metals pledged (held) to the bank act as collateral.

5.2.3.3. if the LTV ratio is not over 70%, when precious metals (except for bank metals) act as collateral pledged on national currency denominated consumer loans.

5.2.3.4 for electric vehicle loans, if the production date is 3 (three) years or less at the time of loan issuance, and a full insurance (auto Casco) agreement is in place for the market value of the vehicle during the loan maturity.

5.2.3.5. for hybrid vehicle loans, if the production date is 1 (one) year or less at the time of loan issuance, and a comprehensive insurance (auto Casco) agreement is in place for the full market value of the vehicle during the loan maturity.

5.2-1. If the DTI ratio for the loans specified in sub-items 5.2.3.4 and 5.2.3.5 of this Regulation exceeds 45%, they are classified as standard assets exposed to additional risks at the time of issuance.

5.3. Sub-items 5.2.2 and 5.2.3 herein apply to restructuring of consumer loans. Sub-item 5.2.3 herein applies to all consumer loans of the borrower in the same bank documented within the last 6 (six) months.

5.4. Sub-items 3.6.4.3, 3.6.5.2, 3.6.6.2 and 3.6.6.3 apply to consumer loans as well.

5.5. Sub-items 3.6.1.1, 3.6.2.1, 3.6.3.1, 3.6.3.2, and 3.6.5.3 herein are assessed at least once a year for borrowers whose total outstanding debt in the same bank exceeds 1 (one) percent of Tier I capital and are classified as per Section 3 herein.

6. Classification of restructured assets

6.1. Unless otherwise specified herein, the classification category at the time of asset restructuring is determined according to the following table, *except for agriculture loans*:

<table>
<tr><th>Classification category</th><th>If restructured for the 1st time</th><th>If restructured for the 2nd time</th><th>If restructured for the 3rd time</th><th>If restructured over three times</th></tr>
<tr><td>Satisfactory</td><td>Watch</td><td>Non-satisfactory</td><td>Doubtful</td><td>Loss</td></tr>
<tr><td>Watch assets and standard assets exposed to additional risks</td><td rowspan="4">Classification category at maximum restructuring</td><td>Non-satisfactory</td><td>Doubtful</td><td>Loss</td></tr>
<tr><td>Non-satisfactory</td><td>Doubtful</td><td colspan="2">Loss</td></tr>
<tr><td>Doubtful</td><td colspan="3">Loss</td></tr>
<tr><td>Loss</td><td colspan="3">Loss</td></tr>
</table>

6.1-1. The classification category is determined according to the following table at the time of agriculture loan restructuring:

<table>
<tr><th>Classification category</th><th>If restructured for the 1st time</th><th>If restructured for the 2nd time</th><th>If restructured over two times</th></tr>
<tr><td>Satisfactory</td><td>Non-satisfactory</td><td rowspan="3">Doubtful</td><td rowspan="4">Loss</td></tr>
<tr><td>Watch</td><td>Non-satisfactory</td></tr>
<tr><td>Non-satisfactory</td><td rowspan="3">Classification category at the time of restructuring</td></tr>
<tr><td>Doubtful</td><td rowspan="2">Loss</td></tr>
<tr><td>Loss</td></tr>
</table>

6.2. The classification category of borrower's new debt liability aimed at repaying his/her overdue loans may not exceed the lowest classification category of those loans.

6.2-1. When consumer loans are restructured and it is not possible to determine the borrower's DTI ratio, loans classified as standard at the time of the first restructuring are categorized as non-satisfactory assets, while loans in the non-standard category are downgraded by one category. If such loans are restructured more than once, they are immediately classified as loss assets.

6.3. Upon restructuring, the asset classification category may be upgraded as follows:

6.3.1. assets whose principal and accrued interest *and/or other payments specified in the agreement* are to be repaid in equal monthly installments (annuity payments) under contractual terms – if there are no delays in payments within half of the remaining period (not more than 6 months for business loans, not more than 12 months for other loans) (10 working days or more).

6.3.2. interbank claims, as well as assets to be repaid by a periodicity other than the periodicity of payments specified in sub-item 6.3.1 herein – if at least 50% of asset's principal amount is repaid and liabilities on the principal amount and accrued interests, *and/or other payments specified in the agreement* are implemented in due time and fully.

6.3.3. considering the requirements of Items 6.3.1 6.3.2 herein, the classification category of restructured assets may be upgraded at most up to watch assets.

6.4. When determining the asset's classification category upon restructuring, asset's quality criteria should be considered along with the requirements of Item 6.3 herein.

6.5. In accordance with the regulations on creation of specific provisions for classification of assets and asset loss provisioning, which were in force until the date of entry into force of this Regulation, the asset that has been improved to the watch asset category and has been in that category for at least recent 12 (twelve) months, whose payments are made in the order of annuity is considered a non-restructured asset as of the effective date of this Regulation. Except for this case, in other cases, an asset that has been restructured once or more before the date of entry into force of this Regulation is considered an asset that has been restructured for the first time for the purposes of this Regulation.

7. Classification of interbank claims

7.1. Interbank claims are classified as follows in terms of delinquency:

Classification category	Satisfactory	Watch	Non-satisfactory	Doubtful	Loss
Delinquency	Non delinquent	1-7 days	8-30 days	31-60 days	over 60 days

7.2. If the bank license is revoked in a forced order or bankruptcy proceedings specified in the Law are initiated with respect to the bank, interbank claims are classified as loss assets.

8. Classification of investments in securities and equity investments

8.1. For classification purposes, securities (except for foreclosed securities) are divided into three categories: high, moderate, and low-quality securities.

8.2. For the purposes herein, high quality securities include government securities of the Republic of Azerbaijan, securities issued by the Central Bank of the Republic of Azerbaijan, backed securities issued by the Mortgage and Credit Guarantee Fund of the Republic of Azerbaijan, as well as securities with a minimum 'A-' credit rating (or equivalent) issued by international rating agencies *and securities issued by multilateral development banks with this credit rating*.

8.3. No reserves are created if investments are made to high quality securities.

8.4. Moderate quality securities include the following taking into account the requirements of Item 8.2 herein:

8.4.1. securities listed or priced daily in the Baku Stock Exchange.

8.4.2. securities with a minimum investment rating given by international rating agencies.

8.4.3. securities that have not received any rating, about the financial state of the issuer of which the bank has sufficient information.

8.5. When investing to moderate quality securities, they are classified as per Part 3 herein.

8.6. Low quality securities include securities, rated by international rating agencies below investment rating or not rated at all and securities, about the financial state of the issuer of which the bank has no sufficient information.

8.7. The portion of carrying value of low-quality securities, below their market price is classified as unsatisfactory, while the portion above their market price as loss assets.

8.8. No reserves are created on securities recorded in income statement daily.

8.9. Equity investments are classified under the quality criteria prescribed in Item 3.6 herein. No reserves are created on the type of assets classified as satisfactory.

9. Classification of assets (property) not used in banking

9.1. From the date of foreclosure other real estate owned (OREO) property not used in banking are classified and provisioned accordingly as follows:

9.1.1. if the market price of real estate is above its book value, it is carried at the book value as an unsatisfactory asset at a minimum.

9.1.2. if the market value of real estate is below its book value, it is carried at the market value as an unsatisfactory asset at a minimum, and difference is recognized as loss asset.

9.2. The OREO and fixed assets previously used by the bank may not be recorded in the balance sheet from the date they are not used for over 2 (two) years. Upon maturity the real estate is charged off from the balance and recorded in an off-balance sheet account.

9.3. Repossessed movable property, including securities from the date of repossession, and movable property not used in banking are classified and provisioned accordingly as follows:

9.3.1. if the market value of movable property is above its book value, it is classified at a minimum as an unsatisfactory asset at the book value within 60 days.

9.3.2. if the market value of movable property is below its book value, it is classified at a minimum as an unsatisfactory asset at the market value within 60 days, whereas difference is recognized as a loss asset.

9.3.3. movable property is classified at least as a doubtful asset after 60-day period expires.

9.3.4. movable property is classified as a loss asset, charged-off, and recognized in a relevant off-balance sheet account after expiry of a 120-day period.

10. Classification of off-balance sheet liabilities

10.1. Off-balance sheet liabilities are divided into 2 groups for classification purposes:

10.1.1. Group 1 – entitles the bank to not fulfill its liabilities fully or partially under the contract unilaterally.

10.1.2. Group 2 – the liability is executed unconditionally.

10.2. Off-balance sheet liabilities are classified on balance sheet assets, as per the requirements determined herein, with the consideration of the following:

10.2.1. Group 1 off-balance sheet liabilities – on the part transferred to the balance sheet from the date the off-balance sheet liability is transferred to balance sheet accounts.

10.2.2. Group 2 off-balance sheet liabilities – 50% for liabilities with a residual term of up to one year from the date of creation of the off-balance sheet liability, 100% for other liabilities with a residual term of more than one year.

10.2.3. guarantees (warranties) issued by the bank – are classified at least as standard assets exposed to additional risks, with no better category than the off-balance sheet category, from the moment they are recognized on the balance sheet account(s).

11. The role of collateral in creating reserves on assets

11.1. Securitization on assets is divided into 5 (five) groups to be considered in asset loss provisioning:

11.1.1. Group 1 securitization:

11.1.1.1. funds in the borrower's, or third party’s deposit account in national and foreign currencies.

11.1.1.2. government securities of the Republic of Azerbaijan, government guarantee, as well as securities issued by the Central Bank.

11.1.1.3. backed securities issued by the Mortgage and Credit Guarantee Fund of the Republic of Azerbaijan.

11.1.1.4. guarantee of the funds established by the government that issue guarantees on fulfillment of liabilities on bank loans.

11.1.1.5. securities and guarantees (warranties) issued by governments or central banks of the countries with the minimum ‘A-’ country (sovereign) debt rating (or equivalent) issued by international rating agencies

11.1.1.6. bank metals deposited to the bank as collateral.

11.1.1.7. securities and guarantees (warranties) issued by multilateral development banks with the minimum 'A-' credit rating (or equivalent) given by international rating agencies.

11.1.1.8. securities and guarantees (warranties) issued by financial institutions with the minimum 'A-' credit rating (or equivalent) given by international rating agencies.

11.1.2. Group 2 securitization:

11.1.2.1. precious metals deposited to the bank as collateral (except for bank metals).

11.1.2.2. guarantees (warranties) given by local banks (banks operating in the Republic of Azerbaijan and local branches of foreign banks) whose credit rating is 3 (three) rates lower than the national (sovereign) debt rating of the Republic of Azerbaijan issued by international rating agencies.

11.1.2.3. securities and guarantees (warranties) not attributable to Group 1 securitization issued by governments or central banks of the countries with minimum investment ratings issued by international rating agencies.

11.1.2.4. securities and guarantees (warranties) not attributable to Group 1 securitization issued by multilateral development banks with minimum investment ratings issued by international rating agencies.

11.1.2.5. securities and guarantees (warranties) not attributable to Group 1 securitization issued by banks with minimum investment ratings issued by international rating agencies.

11.1.2.6. securities traded on the Baku Stock Exchange or issued by companies registered in the countries with a minimum 'A' credit rating (or equivalent) issued by international rating agencies.

11.1.3. Group 3 securitization:

11.1.3.1. real estate.

11.1.4. Group 4 securitization:

11.1.4.1. vehicles, ships, planes, helicopters.

11.1.4.2. Production equipment, installations, installed production lines, and logistics equipment (special equipment and installations used in storage areas and warehouses) utilized in the primary operations of the borrower. Here, the primary operations of the borrower refer to the activities that contribute to the formation of at least 50 (fifty) percent of the borrower's current or future (based on business or strategic plans) projected revenues and cash flows.

11.1.5. Group 5 securitization:

11.1.5.1. other collateral not included to the previous groups.

11.2. If Group 1 securitization acts as asset collateral, no provision is made for the unconditionally secured portion of the asset. In case of the delinquency for more than 60 (sixty) days on an asset with Group 1 securitization, that asset is classified in accordance with the relevant clauses of this Regulation and provisioned.

11.3. Group 2, 3 and 4 securitizations (except for Group 2 guarantees (warranties)) is considered only on provisioning on loss assets. In this case, net market price of securitization is considered under the following conditions:

11.3.1. net market price considered in calculation should not exceed total asset amount.

11.3.2. bank's rights over collateral should be documented under the legislation.

11.3.3. maturity of collateral may not be less than that of the liability it secures.

11.3.4. there should be a liquid market to sell the collateral.

11.3.5. the value of collateral should be revalued.

11.3.6. the collateral's market price should be set by independent appraisers.

11.4. If the terms in Item 11.3 herein are met, reserves on loss assets are calculated as follows:

$$E = (A - L \times i) \times 100\%$$

where: E – reserve amount, A – total asset amount, L – net market value of the collateral recognized, i – a ratio per securitization group for calculation of the liquid value of collateral. The calculation is based on the securitization group with the higher liquid value than the one specified in Item 11.5 herein.

11.5. Ratios on securitization groups for calculation of the liquid value of collateral are as follows:

11.5.1. on Group 2 – 50% of the net market price.

11.5.2. on Group 3:

11.5.2.1. in case of the residential real estate – 40% of the net market price.

11.5.2.2. in case of other real estate not attributed to those in sub-item 11.5.2.1 herein – 30% of the net market price.

11.5.3. on Group 4 – 20% of the net market price.

11.5.4. Group 5 securitization is not considered in creation of reserves.

11.6. If the collateral is not sold within 3 (three) years after the asset is included in the loss assets category, a reserve of 100% on the amount of that asset is created (skipping Item 11.5 herein).

Annex 1
to the 'Regulation on creation of specific provisions for assets classification and loan loss provisioning'

Calculation of the difference between income of a borrower or members of a joint group of borrowers and their debt burden

$$\sum_{n}(I-(D+PMT)) \geq SM \times n$$

Where,

I – borrower's net income after taxes,

D – borrower's debt burden,

PMT – monthly repayment on a new loan,

n (n=1,2,...) – the number of joint borrowers,

SM – cost of living indicator set on the country with the relevant law of the Republic of Azerbaijan on the relevant year.

Annex 2
to the 'Regulation on creation of specific provisions for assets classification and loan loss provisioning'

Calculation of the debt-to-income (DTI) ratio

$$DTI = \frac{\sum_n (D + PMT)}{\sum_n I} \times 100\%$$

Where,
DTI – debt-to-income ratio,
D – borrower's debt burden,
PMT – monthly installment on a new loan,
I – borrower's net income after taxes,
n (n=1,2,...) – the number of the members of a joint group of borrowers.