

“Approved”
Central Bank of
the Republic of Azerbaijan
Resolution № 49/2
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Regulations on foreign currency exchange operations between the Central Bank of the Republic of Azerbaijan and banks

1. General provisions

1.1. These Regulations regulate procedures for foreign currency exchange operations between the Central Bank of the Republic of Azerbaijan (hereinafter – the Central Bank) and banks in accordance with Items 6 and 7 Article 3 of the Law of the Republic of Azerbaijan on Currency Regulation, as well as Article 22.0.4 of the Law of the Republic of Azerbaijan on the Central Bank of the Republic of Azerbaijan.

1.2. The definitions used herein bear the following meanings:

1.2.1. organized interbank foreign exchange market (hereinafter – OIFXM) – a trade platform for foreign exchange operations between the Central Bank and banks, as well as between banks themselves;

1.2.2. foreign currency (FX) intervention – buy/sell operations of foreign currencies against the manat between the Central Bank and banks to maintain stability of the manat;

1.2.3. banks – banks and local branches of foreign banks operating in the Republic of Azerbaijan;

1.2.4. FX transaction – an agreement on exchange of foreign currency against the manat between parties;

1.2.5. direct auction – an auction held at an exchange rate announced by the Central Bank;

1.2.6. competitive auction – an auction where orders are submitted at an exchange rate set by banks;

1.2.7. an order book – a screen in the OIFXM where submitted FX buy and sell orders are sorted from the order with the best exchange rate to the order with the worst one (from the highest to the lowest exchange rate for buy orders, from the lowest to the highest exchange rate for sell orders);

1.2.8. counteragent – a bank that is a participant of the OIFXM and acts as a counterparty in the FX transaction concluded with the Central Bank;

1.2.9. value date – date specified by the parties for settlement in accordance with provisions of the FX transaction;

1.2.10. FX spot (hereinafter – spot) – a financial tool whose value date is no later than 2 (two) working days from the date of the transaction that provides for an exchange of a foreign currency against the manat where one party acts as a buyer and the other as a seller;

1.2.11. FX swap (hereinafter – swap) – a financial tool that provides for exchange of foreign currency against the manat on the near leg date at a near rate and the subsequent exchange in the opposite direction on the swap pre-determined far leg date at the swap far rate;

1.2.12. swap near leg – exchange of foreign currency against the manat at a near rate on the near leg date;

1.2.13. swap far leg – an opposite exchange of foreign currency against the manat at a far rate on the far rate date;

- 1.2.14. swap near leg date – the date of settlement on the swap near leg;
- 1.2.15. swap far leg date – the date of settlement on the swap far leg;
- 1.2.16. swap near rate – an exchange rate of the foreign currency exchange operations of the Central Bank against the manat on the swap near leg date;
- 1.2.17. swap far rate – the exchange rate of opposite exchange operation with foreign currency against the manat on the swap far leg date;
- 1.2.18. swap points – difference between swap's far and near rates;
- 1.2.19. FX forward (hereinafter – forward) – a financial tool whose value date is more than 2 (two) working days from the date of the transaction that provides for an exchange of a foreign currency against the manat at an agreed exchange rate where one party acts as a buyer and the other as a seller;
- 1.2.20. cash-settled non-deliverable forward – a financial tool where one party acts as a buyer and the other as a seller, and does not actually involve currency exchange on the value date, but only provides for payment in manat of the amount resulting from the difference between forward and official exchange rates as of the forward date;
- 1.2.21. forward buyer – the buying party of a foreign currency in a forward agreement;
- 1.2.22. forward seller – the selling party of a foreign currency in a forward agreement;
- 1.2.23. forward rate – exchange rate used to calculate amount of payment on the forward date for cash settled non-deliverable forward against the manat on the forward date; for FX forward, the rate used for foreign currency exchange against the manat as of the forward date;
- 1.2.24. forward date – the date pre-determined by the parties, on which a foreign currency is exchanged against the manat for FX forward, the amount of payment is calculated for cash settled non-deliverable forward;
- 1.2.25. forward period – the number of days between the forward transaction date and the forward date;
- 1.2.26. FX option (hereinafter – option) – a financial tool that entitles the holder to buy (call option) or sell (put option) a foreign currency on a predetermined date and price, and obliges the option writer to execute the FX transaction under agreed terms;
- 1.2.27. option strike price – pre-agreed price between the option holder and the option writer on purchase (sale) of foreign currency on the option expiration date;
- 1.2.28. option expiration date – the date on which the right of the option holder to buy (sell) a foreign currency from (to) the option writer can be exercised;
- 1.2.29. option premium – amount paid by the option holder to the option writer as of the option date.

2. Foreign exchange intervention of the Central Bank

- 2.1. FX interventions are conducted at auction or out-of-auction transactions in the OIFXM.
- 2.2. Only banks can participate as Central Bank's counteragents in FX intervention operations.
- 2.3. The Management Board of the Central Bank or an internal committee duly designated takes a decision on FX intervention currency, direction, amount, exchange rate, conducting methods (auction or out-of-auction), as well as main parameters of an auction (including frequency and time of auctions, limits on the number of orders or on the size of orders that can be placed by a bank) and financial tools used during the FX intervention.

3. FX interventions at auctions and out-of-auctions

- 3.1. Banks that meet the following requirements are allowed to FX intervention auctions:

3.1.1. banks whose operations are not restricted or prohibited as part of supervisory measures implemented in accordance with the Law of the Republic of Azerbaijan on Banks;

3.1.2. banks with no delinquent liabilities to the Central Bank;

3.1.3. banks that do not breach the reserve requirement for the past maintenance period.

3.2. Banks that violate the reserve requirement for past maintenance period are not allowed to FX auctions during the next maintenance period.

3.3. All banks entitled to participate at auctions are sent notifications at the OIFXM 30 (thirty) minutes prior to the auction with respect to the auction. The notification should include:

3.3.1. the date and time of the auction;

3.3.2. currency of the auction and direction (buy/sell) of the Central Bank's operation;

3.3.3. limit on the number of orders that can be placed by one bank;

3.3.4. limit on the size of orders that can be placed by one bank (if applicable);

3.3.5. the exchange rate of the auction (if applicable);

3.3.6. auction amount (if applicable);

3.3.7. a band of deviation of order's exchange rates from an official exchange rate (if applicable).

3.4. Auctions can be held as direct or competitive auctions.

3.5. At a direct auction orders are placed at a pre-announced exchange rate of a foreign currency against the manat. If the volume of orders cannot be fully satisfied, orders are executed proportionally.

3.6. In a competitive auction, if a deviation band is set in accordance with sub-item 3.3.7 herein orders are submitted within that band, if a deviation band is not set, without any restrictions.

3.7. Orders submitted during a competitive auction are executed starting from the order placed with the highest rate to the order placed with the lowest rate that allows the amount to be fully executed. If the volume of orders with the same price conditions cannot be fully executed, these orders are executed proportionately.

3.8. Orders placed by banks can be changed or withdrawn during the bidding time. Conditions specified in the order are considered the bank's offer for conducting a FX transaction.

3.9. In case of lack of the equivalent of the full amount of the order in the bank's correspondent account in manat at the end of the auction, the order will not be executed.

3.10. After the end of the bidding time at the auction, banks are notified at the OIFXM on the result of the auction within 30 (thirty) minutes at the latest. The notification confirms conclusion of the FX transaction between the bank participating in the auction and the Central Bank and the obligation to conduct settlement between the parties.

3.11. In case of an out-of-auction FX intervention, Central Bank's foreign currency exchange operation is conducted with one of the following exchange rates by the decision of the Management Board of the Central Bank or the internal committee duly designated in accordance with Item 2.3 herein:

3.11.1. at an official exchange rate;

3.11.2. at an exchange rate of orders in the the orders book;

3.11.3. at a calculated exchange rate by applying a deviation band from the exchange rate set.

4. Financial tools used during forex intervention

4.1. As a rule, FX intervention is conducted through the spot transaction.

4.2. Depending on goals of the monetary and exchange rate policy, swap, forward, cash-settled non-deliverable forward, options and other financial tools may be used along with the spot.

4.3. Swap

4.3.1. The swap's near rate is equal to the official exchange rate of the transaction day.

4.3.2. The swap's far rate is calculated with the below formula:

$$BM_{v_m/v_x} = AM_{v_m/v_x} + SB_{v_m/v_x}$$

where:

- BM_{v_m/v_x} - swap's far rate;
- AM_{v_m/v_x} - swap's near rate;
- SB_{v_m/v_x} - swap points;
- v_x - foreign currency;
- v_m - manat

4.3.3. Swap points are calculated with the below formula:

$$SB_{v_m/v_x} = AM_{v_m/v_x} * \left[\frac{1 + R_m * \frac{T}{360}}{1 + R_x * \frac{T}{D_x}} - 1 \right]$$

where:

- R_m - interest rate on the manat;
- R_x - interest rate on the foreign currency;
- T - the number of days between the swap's near and far leg dates;
- D_x - number of days according to the day count convention (360 or 365) used for the foreign currency based on global market practice

4.4. Forward

The forward rate is calculated with the below formula:

$$S_{fw} = S_{v_m/v_x} * \frac{1 + R_m * \frac{T}{360}}{1 + R_x * \frac{T}{D_x}}$$

where:

- S_{fw} - forward exchange rate;
- S_{v_m/v_x} - exchange rate of the Central Bank's operation on exchange of the manat against the foreign currency as of the transaction date;
- R_m - interest rate on the manat;
- R_x - interest rate on the foreign currency;
- T - the number of days between forward agreement and forward dates;
- D_x - number of days according to the day count convention (360 or 365) used for the foreign currency based on global market practice;

4.5. Cash-settled non-deliverable forward

4.5.1. Amount of payment on cash-settled non-deliverable forward is calculated with the below formula:

$$C_f = N * |S_{fw} - S_T|$$

where:

- C_f - payment amount;
- N - amount of currency which is the underlying asset used only for purposes of calculating payment amount and not meant for exchange between the parties;
- S_{fw} - forward rate (calculated with the formula in Item 4.4 herein);
- S_T - spot rate as of the forward date.

4.5.2. During cash settled non-deliverable forward payment between the parties is maintained as follows:

4.5.2.1. in case the official exchange rate on forward date is lower (higher) than the forward rate, the forward buyer (forward seller) pays the payment amount to the forward seller (forward buyer);

4.5.2.2. in case the official exchange rate on forward date is equal to the forward rate as of the forward date, no payment is made between the parties.

4.6. FX option

4.6.1. The option premium is calculated based on the option price and is equal to the option price multiplied by the nominal value of the option.

4.6.2. Prices for call and put options are calculated with the below formulas respectively:

$$c = S_{v_m/v_x} * e^{\frac{-R_x * T}{365}} * N(d_1) - K_{v_m/v_x} * e^{\frac{-R_m * T}{365}} * N(d_2)$$

$$p = K_{v_m/v_x} * e^{\frac{-R_m * T}{365}} * N(-d_2) - S_{v_m/v_x} * e^{\frac{-R_x * T}{365}} * N(-d_1)$$

At that, the coefficients d1 and d2 are calculated with the below formulas:

$$d_1 = \frac{\ln\left(\frac{S_{v_m/v_x}}{K_{v_m/v_x}}\right) + \left(R_m - R_x + \frac{\sigma^2}{2}\right) \frac{T}{365}}{\sigma \sqrt{\frac{T}{365}}}$$

$$d_2 = d_1 - \sigma \sqrt{\frac{T}{365}}$$

where:

c - call option's price in underlying currency;

p - put option's price in underlying currency;

S_{v_m/v_x} - the exchange rate of the exchange operation of the Central Bank of a foreign currency against the manat as of the option date;

K_{v_m/v_x} - option strike price;

R_m - interest rate on the manat;

R_x - interest rate on the foreign currency;

T - the number of days between the option date and the option expiration date;

σ - volatility of the currency pair;

$N(d_1)$ - option price sensitivity against exchange rate changes;

$N(d_2)$ - probability of execution of the option by the option holder