

Regulation on prudential ratios and requirements related to credit risks, including large credit risk exposures

1. General provisions

This Regulation has been developed in accordance with Articles 34.2.5, 34.2.6 and 34.5 of the Law of the Republic of Azerbaijan on Banks and determine maximum amount of credit risks, aggregate large credit risks, as well as other related credit risks regarding credit exposures on a single borrower or a group of related borrowers and procedures for application of these ratios in banks and local branches of foreign banks operating in the Republic of Azerbaijan (hereinafter – banks).

2. Definitions

2.1. The definitions used herein bear the following meanings:

2.1.1. maximum amount of credit risks – the upper limit of the bank's credit exposure for a single borrower or a group of related borrowers.

2.1.2. amount of large credit risk – amount of credit exposure (large credit exposure) due from one borrower or a group of related borrowers exceeding 10% (ten) of bank's Tier I capital after deductions.

2.1.3. credit exposure – bank's claim rights in connection with fulfillment of any type of liabilities, *including those obtained by a bank that were previously issued without adhering to the same prudential or regulatory requirements*, as well as any commitment made to provide funds, guarantee, warranty, purchase of debt securities and another right related to claiming the funds issued in any form under the agreement. Unless otherwise specified in this Regulation, principal debt on credit exposure is considered in calculations.

2.1.4. borrower – an individual or a legal entity who has a liability to the bank in any form on credit exposure.

2.1.5. non-bank financial institutions (NBFI) – financial institutions providing financial services other than attracting deposits (savings) (NBCIs, credit unions, lessors, insurance, factoring, pawnshops, and other similar organizations).

2.1.6. 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. vehicle – the vehicle purchased by individuals for personal consumption.

2.1.8. real estate loan - a loan given to individuals for acquisition or construction of real estate for personal consumption.

2.1.9. the loan-to-value (LTV) ratio – the ratio of total loan amount (principal and interest to be calculated under the loan agreement) to the market value of collateral.

2.1.10. multilateral development banks – an international financial institution established by two or more countries to support economic development.

2.1.11. bank acceptance – a document envisaging the bank's consent or guarantee to execution of short-term debt liabilities.

2.1.12. liquid market – a market where there are enough offers to buy/sell, and where it is possible to sell within a reasonable time and at a market price.

2.1.13. partially secured or unsecured credit exposure – when the types of collateral specified in Item 5.3 herein act as collateral for a credit exposure and their market value is less than 100% (one hundred) of the amount of the liability, and when other types of collateral with less than 150% (one hundred and fifty) except for the cases specified in this Regulation.

2.2. The definitions debt-to-income (DTI) ratio, *consumer loans and the scope of securitization groups*, used in this Regulation bear the meaning specified in the 'Regulation on assets classification and creation of special reserves for loan loss provisioning.'

2.3. *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).*

2. Group of related borrowers

3.1. Borrowers are considered related when:

3.1.1. one of the borrowers has significant influence on bank's another borrower.

3.1.2. the same person (whether a borrower) has considerable influence on two or more borrowers of the bank.

3.1.3. the person who has joint or subsidiary liability for obligations of any borrower is a borrower of the bank.

3.1.4. the same person (whether a borrower) has a joint or subsidiary liability on obligations of two or more persons who are borrowers of the bank.

3.1.5. a borrower gives a loan from a bank to another borrower in any form; or two or more borrowers together or separately transfer the loan they take from the bank to the same person (whether a borrower) (except for the cases when funds are transferred to the same goods or service provider by one or more borrowers for commercial purposes).

3.1.6. borrowers jointly use bank loans to generate income.

3.1.7. more than 50% (fifty) of one borrower's income or expenses (including consolidated income and expenses) is related to another borrower of the bank.

3.1.8. two or more borrowers use the same source to meet liabilities or pledge the same collateral, or more than 50% (fifty) of their income is earned from the same person.

3.2. A person is deemed to have significant influence on another person when:

3.2.1. he has a qualifying holding of 10% (ten) or more of the legal entity's capital.

3.2.2. the person of the legal entity with qualifying holding, is the person with the right to influence legal entity's decision-making based on a contract concluded with governing bodies or another authorized person or on other grounds or may manage its affairs.

3.2.3. he/she is a founder (participant) with a joint or subsidiary liability on obligations of the legal entity.

3.3. A legal entity whose majority holding is owned by the state (and its staff) and another legal entity whose majority holding is owned by the state (its staff) are not included to a group of related borrowers.

4. Maximum amount of credit risks

4.1. The maximum amount of the credit risk on a single borrower or a group of related borrowers may not exceed 25% (twenty-five) of Tier I Capital after deductions.

4.2. Maximum amount of partially secured or unsecured credit exposure(s) on a single borrower or a group of related borrowers may not exceed 10% (ten) of Tier I Capital after deductions, except for credit exposures against the banks operating in the Republic of Azerbaijan; non-resident banks with a minimum investment rating issued by international rating agencies (Standard & Poor's, Fitch Ratings, Moody's, hereinafter – international rating agencies); real estate loans issued in accordance with the LTV ratio set in this Regulation, *as well as project financing loans, issued in accordance with the requirements of the 'Regulation on prudential regulation of project financing loans'*. The following should be considered during calculation:

4.2.1. the portion of the market value of Group 5 securitization specified in the 'Regulation on creation of special reserves for assets classification and loan loss provisioning' over 25% (twenty-five) of total amount of the credit exposure is not considered.

4.2.2. it is determined whether each credit exposure is separately *classified* as a partially secured or unsecured loan, and then credit exposures attributed to the partially secured or unsecured loan category are aggregated on a single borrower or a group of related borrowers.

4.3. The credit risk of a systemically important bank on another systemically important bank may not exceed 15% (fifteen) of Tier I Capital after deductions.

4.4. Maximum amount of credit risks of the bank on NBFIs is set as follows:

4.4.1. credit exposure per NBFI should not exceed 7% (seven) of Tier I Capital of the bank after deductions.

4.4.2. aggregate credit exposure on NBFIs should not exceed 30% (thirty) of Tier I Capital after deductions.

4.5. The maximum amount of the credit risk of the bank on a car loan of one borrower should not exceed the following (only principal debt is considered in the calculation of the LTV ratio):

4.5.1. regardless of the price, when the production date is 3 (three) years or less at the time of the loan approval for electric vehicles – the LTV ratio 90%, if over 3 (three) years – the LTV ratio 60%.

4.5.2. regardless of the price, when the production date is 1 (one) year or less at the time of loan approval for hybrid vehicles – the LTV ratio 80%, over 1(one) year and 3 (three) years or less – the LTV ratio 60%, over 3 (three) years – the LTV ratio 50%.

4.5.3. when the production date on vehicles not attributable to sub-items 4.5.1 and 4.5.2 herein is 1 (one) year or less at the time of loan approval – the LTV ratio 60%, over 1 (one) year and 3 (three) years or less – the LTV ratio 50%, over 3 (three) years – 40%.

4.6. Except for the below cases, consumer loans are issued to borrowers whose DTI ratio is not over 70% (seventy):

4.6.1. *when deposits (belonging to the borrower or a third party) held with the same bank are used as collateral for national currency denominated consumer loans, the LTV ratio is not over 100%; when other Group 1 securitization is used, the LTV ratio is not over 90%; and when precious metals pledged as bank collateral (excluding bank metals) are used, the LTV ratio is not over 70%.*

4.6.2. If foreign currency deposits with the same bank (belonging to the borrower or a third party) or *other Group 1 securitization*, function as collateral for consumer loans in foreign currency if the LTV ratio is not over 90%.

4.6-1. *The total amount of consumer credit lines exceeding 5 (five) times the borrower's net income after tax should not exceed 1 (one) percent of the bank's Tier 1 capital after deductions. All obligations of the borrower to all credit institutions are taken into account in calculations, except for credit lines secured by the collateral specified in sub-items 4.6.1 and 4.6.2 herein.*

4.7. Foreign currency denominated consumer loans are issued to borrowers who have income in a foreign currency. Consumer loans in a foreign currency are issued to borrowers who do not have income in a foreign currency as per sub-item 4.6.2 herein.

4.8. Aggregate amount of all credit exposures on consumer loans with 5 (five) year and over maturity (including restructured consumer loans) may not exceed 0,1% of Tier I Capital after deductions.

4.9. Real estate loans are issued only in the national currency. At that, the maximum amount of the bank's credit risk on a real estate loan per borrower should not exceed the following (only principal debt is considered in calculation of the LTV ratio):

4.9.1. when issued to an individual who does not own a residential area for purchase of a residential area and is secured with a mortgage of that residential area – the LTV ratio 85%.

4.9.2. the real estate loan not attributable to sub-item 4.9.1 – the LTV ratio 70%.

4.10. The amount of aggregate large credit risk exposures may not exceed 8 (eight) times of Tier I Capital of the bank after deductions.

4.10-1. *Total amount of all credit exposures issued under the behavioral model established according to the 'Regulation on credit risk management in banks,' approved by Resolution No. 46/4 of the Management Board of the Central Bank of the Republic of Azerbaijan dated 21 September 2023, should not exceed 10% of the bank's lending portfolio as of the end of the previous reporting month. When the outstanding amount of loans issued under the model and delinquent*

for more than 90 days reaches 10% of the respective lending portfolio, the issuance of loans under the model is suspended (calculations are carried out separately for each credit type, such as consumer, business, etc.).

4.10-2. *The issuance of loans under the model may be resumed if the overdue portion of loans issued under the behavioral model falls below the limit specified in Item 4.10-1 herein.*

4.11. Bank's large credit exposure is created or increased to the level specified in this Regulation at the decision of the Supervisory Board.

5. Exceptions allowed and the role of securitization in calculation of the maximum amount of credit risks

5.1. When calculating maximum amount of credit risks, principal amount of credit exposure is recorded less relevant general reserves.

5.2. The following credit exposures are not considered (not included to calculation) in the calculation of the maximum amount of credit risks):

5.2.1. amounts due to the Government of the Republic of Azerbaijan and the Central Bank of the Republic of Azerbaijan (hereinafter – the Central Bank).

5.2.2. amounts due to governments and central banks of the countries with minimum 'AA-' country (sovereign) debt rating (or equivalent) issued by international rating agencies.

5.2.3. exposures on one day interbank operations (overnight/intraday).

5.2.4. exposures on interbank secured money market.

5.2.5. correspondent account balances (in case of banks operating in the Republic of Azerbaijan, as well as banks with minimum investment rating issued by international rating agencies).

5.3. When the following types of collateral function as securitization for a credit exposure, the unconditionally secured part of the credit exposure is reduced in the following manner during the calculation of the ratios defined in Part 4 herein (not included in the calculation):

5.3.1. government securities of the Republic of Azerbaijan, as well as securities issued by the Central Bank and in case of government guarantee – 100% (one hundred).

5.3.2. the national currency, bank metals or the currency of the countries with the minimum investment rating issued by international rating agencies (equivalent in case credit exposure is not in the currency of securitization) – 100% (one hundred).

5.3.3. securities and guarantees (warranties) issued by governments or central banks of the countries with the minimum 'A-' country (sovereign) credit rating issued by international rating agencies (or equivalent) – 100% (one hundred).

5.3.4. securities and guarantees (warranties) issued by multilateral development banks with the minimum investment rating issued by international rating agencies – 100% (one hundred).

5.3.5. backed securities issued by the Mortgage and Credit Guarantee Fund of the Republic of Azerbaijan – 100% (one hundred).

5.3.6. guarantee of the funds established by the state that issues guarantee on execution of liabilities on bank loans – 80% (eighty).

5.3.7. securities and guarantees (warranties) issued by governments and central banks of the countries with the minimum investment rating issued by international rating agencies – 80% (eighty).

5.3.8. securities and guarantees (warranties) issued by banks with the minimum investment rating issued by international rating agencies, as well as those issued the banks operating in the Republic of Azerbaijan whose credit rating issued by international rating agencies is 3 (three) rates lower at most than the country (sovereign) debt rating of the Republic of Azerbaijan – 50% (fifty).

5.3.9. securities and guarantees (warranties) issued by financial institutions with the minimum 'A-' credit rating (or equivalent) issued by international rating agencies – 50% (fifty).

5.4. Except for the types of securitizations specified in sub-items 5.3.1 and 5.3.2 herein, maximum amount of the credit risk on the credit exposure of other types of securitizations specified in Item 5.3 that act as collateral (without reducing the secured portion of the credit exposure as per Item 5.3 herein) may not exceed 50% (fifty) of Tier I Capital of the bank after deductions.

5.5. At least the following terms and conditions should be provided along with the requirements specified in the normative act that regulates procedures for credit risk management in banks to consider the secured portion of the credit exposure in the calculation of the ratios specified in this Regulation:

5.5.1. the rights of the bank over collateral should be documented in accordance with the legislation.

5.5.2. duration of collateral should not fall below the maturity of the liability it secures.

5.5.3. the market value of collateral should be revalued at least once a year.

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

5.6. The following portion of off-balance sheet liabilities is considered in the calculation of the maximum amount of credit risks (included to the calculation):

5.6.1. 10 (ten) percent of obligations under the agreement that grant the bank the unilateral right not to fully fulfill its obligations.

5.6.2. 20 (twenty) percent of off-balance sheet liabilities with up to one year maturity.

5.6.3. 50 (fifty) percent of off-balance sheet liabilities with a maturity of more than one year.

5.6.4. undertakings related to credit lines, bank acceptance, and the purchase and sale of securities in full.

6. Elimination of violations regarding ratios and reporting

6.1. If it is found out that the bank has violated the ratios set in this Regulation, the Chief Risk Officer should inform the Central Bank no later than the next business day.

The information should specify the reasons for the violation and measures to be taken for their elimination.

6.2. The bank should eliminate the violation of ratios within the following periods when:

6.2.1. Tier I Capital of the bank decreases - within 60 (sixty) calendar days.

6.2.2. the market value of collateral decreases or is lost - within 60 (sixty) calendar days.

6.2.3. a single borrower becomes a group of related borrowers – within 60 (sixty) calendar days.

6.3. The bank delivers to the Central Bank the following information related to credit exposures monthly together with prudential reports:

6.3.1. bank's large credit exposures without applying the requirements of Items 5.1 and 5.3 herein.

6.3.2. large credit exposures after the requirements of Items 5.1 and 5.3 herein are applied.

6.3.3. bank's large credit exposures specified in Item 5.2 herein except for the credit exposures specified in sub-item 5.2.3 herein.

6.3.4. 20 (twenty) largest credit exposures to a single borrower or a group of related borrowers (regardless of whether the amount exceeds 10% (ten) of the bank's Tier I Capital after deductions).

7. Final provisions

7.1. The requirements of sub-item 4.2.1, Items 4.6, ~~4.8~~ and 5.4, as well as the requirement of sub-item 5.6.4 on considering credit lines in the calculation in full apply to credit exposures created after this Regulation takes effect.

7.1-1. The requirement of Item 4.8 herein applies to consumer loans issued after the date of entry into force of this Regulation, as well as issued until the date of entry into force of this Regulation, but whose total maturity (the period before and after restructuring) as a result of restructuring after the date of entry into force of the Regulation is 5 (five) years and over.

7.2. The requirements of Items 4.6 and 4.8 herein do not apply to student loans issued at the expense of resources of the Education Student Loan Fund operating under the Ministry of Education of the Republic of Azerbaijan.

7.3. The requirement of Item 4.6-1 of this Regulation applies to consumer credit lines granted after the date this item takes effect, as well as to those whose limit or term has been increased thereafter.