

“Approved”
Central Bank of
the Republic of Azerbaijan
Resolution № 46/1

15 November 2024

Regulation on prudent management of non-bank credit institutions

1. General provisions

1.1. This Regulation has been developed in accordance with Articles 7.2 and 19 of the Law of the Republic of Azerbaijan ‘on Non-bank credit institutions’ (hereinafter – the Law) and determines prudential norms and standards regarding activities of non-bank credit institutions (hereinafter – NBCIs).

1.2. Relations related to credit risk management by NBCIs are governed by the ‘Regulation on credit risk management in non-bank credit institutions’ approved by Resolution No 46/2 of the Management Board of the Central Bank of the Republic of Azerbaijan (hereinafter – the Central Bank) dated 15 November 2024.

2. Definitions

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

2.1.1. assets – loans issued by NBCIs, other assets placed with a condition of return, prepaid funds, assets not used in operations of NBCIs, investments in shares of legal entities, and off-balance sheet liabilities.

2.1.2. borrower – an individual or a legal entity with a monetary obligation to an NBCI under a credit agreement.

2.1.3. special reserves – funds allocated from expenses to cover expected asset losses.

2.1.4. securitization – an asset pledged by the borrower or a third party to secure the fulfillment of obligations, such as collateral, mortgage, guarantee, warranty, or other forms of security specified in the Civil Code of the Republic of Azerbaijan.

2.1.5. fully secured asset – the asset backed by the security whose market value (the face value in relation to cash funds, guarantees, and warranties) is equal to or greater than the outstanding amount of the liability it secures.

2.1.6. partly secured asset – the asset backed by the security whose market value (the face value in relation to cash funds, guarantees, and warranties) is lower than the outstanding amount of the liability it secures.

2.1.7. unsecured asset – loan without any security or whose security has no market (face) value.

2.1.8. residual amount – unpaid part of the loan principal or the carrying value of a non-loan asset.

2.1.9. total amount – the sum of the residual value of an asset and the accrued interest, commission fees, penalties, and other unpaid amounts associated with that residual.

2.1.10. credit claims – the claim rights of the NBCI related to the fulfillment of monetary obligations in any form, as well as any commitment to provide funds, guarantees, purchase debt

securities, or other rights to demand the repayment of funds provided under an agreement in any form. For calculations, the principal amount of the credit claim is considered.

2.1.11. off-balance sheet liabilities – guarantees, warranties and similar contingent liabilities, credit instruments (the unused portion of obligations under credit lines and similar credit commitments).

2.2. The definitions ‘consumer loan’, ‘daily (short-term) loan’, ‘business loan’, ‘agri loan’, ‘real estate loan’ and ‘restructured’ used in this Regulation bear the meanings specified in the ‘Regulation on credit risk management in non-bank credit institutions’, and ‘a joint group of borrowers’, ‘capital’ and other definitions bear the meanings specified in the Law.

3. Prudential norms and requirements

3.1. The following norms and requirements are established regarding the activities of NBCIs:

3.1.1. minimum amount of authorized (share) capital (property rights).

3.1.2. requirement for the minimum amount of capital and its calculation.

3.1.3. maximum amount of a loan to one borrower and a group of joint borrowers.

3.1.4. maximum amount of loans to related parties and requirements for operations with them.

3.1.5. the NBCI liabilities to its capital ratio.

3.1.6. requirements regarding special reserves created at the expense of costs for covering potential losses, depending on the classification and valuation of assets and off-balance-sheet liabilities.

4. Minimum amount of authorized (share) capital (property rights)

4.1. Depending on its organizational and legal form, each NBCI should have authorized (share) capital (property rights) and, throughout its operations, should ensure that this capital does not fall below the minimum amount specified in Item 4.3 of this Regulation.

4.2. The minimum authorized (share) capital of an NBCI, as well as property rights of the founders of an NBCI established as a non-commercial legal entity, should be paid in cash in accordance with Article 7.1 of the Law and be formed exclusively in manat.

4.3. The minimum amount of authorized (share) capital (property rights) of NBCIs is established as follows:

4.3.1. For an NBCI established as a commercial legal entity – 1 (one) million manat.

4.3.2. For an NBCI established as a non-commercial legal entity – 100 (one hundred) thousand manat.

5. Minimum amount of capital and its calculation

5.1. The main purpose of an NBCI's capital is to support its commercial strategy and ensure the financial stability of the NBCI in the event of unfavorable changes in the internal and external environment. The capital serves to reduce potential losses that could lead to the loss of the NBCI's solvency and increase the trust of potential investors in NBCI's operations.

5.2. The minimum amount of the NBCI capital is established in the following amount:

5.2.1. For an NBCI established as a commercial legal entity – 1 (one) million manat.

5.2.2. For an NBCI established as a non-commercial legal entity – 100 (one hundred) thousand manat.

5.3. The capital structure is established as per Item 1.0.7 of the Law. The capital includes only financial instruments paid in cash.

5.4. The following are deducted from capital when calculating the capital:

5.4.1. net value of intangible assets (including amortization).

5.4.2. amount of deferred tax assets determined with the International Financial Reporting Standards (IFRS).

5.4.3. Investments of NBCIs to subsidiaries, as well as the capital of other legal entities.

5.5. When calculating capital, reserves created on satisfactory assets are not deducted from capital.

6. Maximum amount of loans to one borrower and a group of joint borrowers

The maximum amount of a loan claim for a borrower and a group of joint borrowers should not exceed 30 (thirty) percent of the NBCI's capital.

7. Maximum amount of loans to related parties and requirements for operations with them

7.1. The total amount of loans to related parties should not exceed the following limits (except in cases where a lower limit is set in NBCO's internal rules):

7.1.1. to one individual – 5 (five) percent of NBCI capital.

7.1.2. to one legal entity – 10 (ten) percent of NBCI capital.

7.1.3. to all related parties – 20 (twenty) percent of NBCI capital.

7.2. It is prohibited to issue preferential loans or conduct transactions under preferential terms to related parties, unlike other customers.

7.3. A related party loan amounting to 5 (five) percent or more of the assets of the NBCI is issued based on the opinion of an independent auditor and the decision of the general meeting of shareholders (or participants) with voting rights or the decision of the Board of Trustees in cases where the NBCI is established as a non-commercial legal entity. A related party loan amounting to less than 5 (five) percent of the assets of the NBCI is issued based on the decision of the executive body of the NBCI established as a non-commercial legal entity, or the Supervisory Board or executive body of the NBCI established as a commercial legal entity, unless the authority to make such a decision has been delegated to the general meeting of shareholders (or participants) or the Board of Trustees, in accordance with the requirements of Item 7.4 of this Regulation.

7.4. The total amount of credit claims issued to all related parties by the executive body of the NBCI should not exceed 1 (one) percent of the NBCI's assets.

7.5. Loans to members of NBCI's executive body (sole manager) can only be issued based on a decision of the Supervisory Board (or Board of Trustees) or the general meeting of shareholders (or participants).

7.6. Members of the Supervisory Board (or Board of Trustees) and the executive body (sole manager) of the NBCI should not participate in discussions or decision-making regarding the issuance of loans to themselves, to persons with kinship relationships as defined in Article 49-1.1.3 of the Civil Code of the Republic of Azerbaijan, or to legal entities in which they have a qualifying holding.

8. The NBCI's liabilities to its capital ratio

8.1. Total liabilities of the NBCI should not exceed 10 (ten) times its capital, calculated as per Section 5 of this Regulation. If the effective annual interest rates of loans constituting 25-50% of the NBCI's lending portfolio exceed 1.25 times the average interest rate on consumer loans (excluding daily

loans) in the national currency within the NBCI sector, total liabilities of the NBCI should not exceed 3 (three) times its capital, as calculated in accordance with Section 5 of this Regulation. If the effective annual interest rates of loans constituting more than 50% of the NBCI's lending portfolio exceed 1.25 times the average interest rate on consumer loans (excluding daily loans) in the national currency within the NBCI sector, total liabilities of the NBCI should not exceed 1 (one) time its capital, as calculated in accordance with Section 5 of these Regulations.

8.2. The average interest rate for consumer loans in the national currency (excluding daily loans) within the NBCI sector, as specified in Item 8.1 of this Regulation, is calculated quarterly by the Central Bank in accordance with the procedure established in Annex 1 herein and is published on the official website of the Central Bank by the 30th of the month following each quarter. Within 1 (one) business day after the publication of the average interest rate for consumer loans in the national currency (excluding daily loans), NBCIs are informed about it via electronic or postal notification. Until the average interest rate for consumer loans in the national currency (excluding daily loans) is published, NBCIs use the data from the previous quarter.

8.3. If a decrease in the NBCI's capital results in a violation of the requirement specified in Item 8.1 herein, the volume of liabilities cannot be increased. In such a case, the violation should be rectified by the NBCI within 3 (three) months.

9. Requirements regarding special reserves created at the expense of costs for covering potential losses, depending on the classification and valuation of assets and off-balance-sheet liabilities

9.1. To clearly and objectively assess its financial position and operational results, the NBCI should evaluate all its assets at least once per quarter and create appropriate provisions in the national currency at the expense of costs, based on the total value of these assets.

9.2. During the evaluation, the NBCI analyzes all its assets and classifies them into the appropriate categories in accordance with this Regulation. The NBCI's internal rules define the procedures for the classification of assets in accounting, including the write-off of loss assets from the balance sheet.

9.3. Assets are divided into standard and non-standard assets. Standard assets are those that are satisfactory and watch, while non-standard assets are those that are non-satisfactory, doubtful and loss.

9.4. Classification of assets according to their delinquency:

9.4.1. The classification category of assets based on the delinquency period is determined according to 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
Partly secured or unsecured asset	0-30 days	31-90 days	91-180 days	181-270 days	over 270 days

9.4.2. The asset's delinquency period (for principal debt or interest payments, and/or other payments specified in the agreement) is calculated based on the date specified in the relevant agreement

or payment schedule for the repayment of the principal debt and/or interest payments and/or other payments indicated in the agreement.

9.5. Unless otherwise specified in this Regulation, the reserve rates for each classification category are determined according to 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	Agri loans in national currency	
Satisfactory assets	1%	2%	1%	2%	1%	1%
Watch assets	5%	10%	2%	3%	2%	2%
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%

9.6. Short-term (daily) loans are classified as 'watch assets' at the time they are issued, and in case of a 1 (one) day delay, they are classified as 'loss assets'.

9.7. If the borrower's loan (excluding daily loans) is restructured once, it cannot be classified into a higher classification category than the one it was in at the time of restructuring. If the loan is restructured twice or more, it should be classified at least as non-satisfactory. Loans classified as 'non-standard' at the time of restructuring should be classified one category lower than their current classification.

9.8. Off-balance sheet liabilities are assessed and classified as follows:

9.8.1. NBCIs classify off-balance sheet liabilities based on individual assessments and under the classification groups specified in item 9.4 of this Regulation, taking into account the collateral of the liability, the financial condition of the customer and the characteristics of the arising risk.

9.8.2. Classification is made from the date the off-balance-sheet liability is created.

9.8.3. The unused portion of the credit line is classified according to the classification category of the used portion of the off-balance-sheet liability (except in cases where the credit agreement grants the right to unilaterally not fulfill the credit line, either partially or fully, as per the terms of the agreement).

9.9. The property repossessed by the NBCI, as well as fixed assets previously used cannot be kept on the balance for more than 2 (two) years from the moment they are no longer used. After this period expires, the assets are removed from the balance sheet and recorded in the off-balance-sheet.

9.10. When evaluating loans and off-balance-sheet liabilities, if the situations outlined in sub-items 9.10.1 and 9.10.2 of this Regulation are identified, the previously created provisions are reduced through the crediting of the corresponding expense account, or the reduced amount of the provision previously deducted from income is added to income:

9.10.1. when the overdue principal debt, interest payments, and/or other payments specified in the agreement are fully repaid (excluding payments made from collateral).

9.10.2. when 2 (two) consecutive payments are made fully and on time.

9.11. A loss asset is written off the balance sheet in the amount of the provision created for that asset. Loss assets are written-off from the balance sheet based on the proposal of the executive body and the decision of the Supervisory Board (or the Board of Trustees). The write-off of loss assets in national currency, up to a total amount of 20,000 (twenty thousand) manat, excluding loans to related parties, may be delegated by the Supervisory Board (or the Board of Trustees) to the executive body.

9.12. All assets written off the balance sheet through provisions are recorded in the corresponding off-balance-sheet accounts (sub-accounts) and are maintained in these accounts for at least 5 (five) years.

9.13. Any amounts received by the NBCI for the payment of assets previously written off the balance sheet as "loss assets" are directed to reduce the relevant expense account or the reduced amount of the provision previously deducted from income is added to income.

10.Final provisions

10.1. This Regulation applies to NBCIs operating before this Regulation comes into force three (3) months after the date this Regulation takes effect (except for Item 4.3), and the prudential regulation of those NBCIs' activities is conducted in accordance with the requirements of the regulations in force until this Regulation comes into force.

10.2. The provisions of Item 4.3 of this Regulation apply to NBCIs established after this Regulation takes effect.

10.3. The requirements of Item 9.7 of this Regulation apply to the loans restructured after the period specified in Item 10.1 herein.

Calculation of the sector's average interest rate on national currency denominated consumer loans

1. The Central Bank calculates the sector's average interest rate on consumer loans in the national currency in the following sequence:

1.1. The average interest rates for the following types of consumer loans issued in the national currency during the previous quarter are obtained from each NBCI:

1.1.1. car loans

1.1.2. credit card loans

1.1.3. housing repair loans

1.1.4. appliance loans

1.1.5 other consumer loans

1.2. The median for the NBCI sector on consumer loans in the national currency is determined based on the obtained average interest rates.

2. The average interest rate for each type of j consumer loan issued in the national currency by each NBCI during the previous quarter (for that specific NBCI) is calculated using the below formula:

$$P_j = \frac{\sum_{k=1}^m (L_{jk} \times I_{jk})}{\sum_{k=1}^m L_{jk}}$$

where:

P_j – the average interest rate of loans for the types of j consumer loans issued in the national currency by the NBCI during the previous quarter.

L_{jk} – The amount of the k - loan issued in the national currency for a specific type of consumer loan j by the NBCI during the previous quarter.

I_{jk} – The interest rate of the k loan issued in the national currency for a specific type of j consumer loan by the NBCI during the previous quarter.

j – the type of the consumer loan.

k – the serial number of the loan, $k = \{1, 2, \dots, m\}$

m – total number of loans issued in the national currency for a specific type of consumer loan j .

3. The NBCI submits the average interest rate calculated in the format specified in Part 2 of this Annex, along with the data underlying the calculations, to the Central Bank as determined by the Central Bank, together with prudential reports.

4. When other payments are specified instead of interest in the loan agreement, the total of those payments is taken into account in the calculation of the average interest rate.