THE INTERNATIONAL BANK OF AZERBAIJAN

Collection of information

On organization of Risk Management

Risks Management – General Information

The Risk Management System at the International Bank of Azerbaijan OJSC (hereinafter referred to as "the Bank") has been established in accordance with the standard legal requirements of the Central Bank of Azerbaijan, Basel Committee's recommendations on Banking Supervision, and the international practice. The Risk Management Policy and Procedures reflecting the procedures for the sphere's activity have been developed at the Bank.

1. Objectives and Duties of the Risk Management Policy

The Risk Management Policy shall set out the following objectives:

- create a reliable bank image that does not undertake risks deemed to be inacceptable, and ensure its protection;
- ensure unconditional performance of the obligations undertaken by the Bank;
- ensure that the Bank undertakes only those risks that are deemed to be acceptable and adequate to the current business volume;
- form the Bank's adequate assets and liabilities portfolio.

The Risk Management Policy shall perform the following duties:

- ensure that the Bank's development strategy is implemented;
- ensure that officials follow the relevant limits and distribution of authorities;
- ensure normal operation of the Bank during crisis;
- ensure that the Bank is not subjected to excess risks for a long time;
- create an effective system for management of assets and liabilities.

2. Principles and Standards of the Risk Management Policy

Principles and Standards of the Risk Management Policy shall be defined as follows:

- reflecting work procedures for all services(products) being provided by the Bank in the relevant internal documents;
- ensuring that there are appropriate procedures at the Bank to manage risks during crisis;
- using “stress-test” methodologies in the management of risks;
- preventing transactions that do not accord with the risk levels acceptable for the Bank and create conditions for generation of risks not explored and classified in good time;
- minimizing the effects of risks associated with any type of the Bank’s activity on the whole operation of the Bank;
- preventing transactions that do not correspond to the requirements provided for by the internal documents;
- ensuring that the level of risk on any type of the Bank’s activity does not significantly differ from the level of risks on other types of the Bank’s activity and general risk level of the banking business;
- following the procedures and mechanisms for risk management in a continuous and permanent fashion;
- transparent and explicit delivery of the risk management system to the general public;
- defining acceptable levels of risk for different customer and partner groups, depending on the peculiarities of relations with customers and partners;
- defining limits and distribution of authorities for carrying out all types of transactions and making decisions;
- preventing use of the Bank’s infrastructure with the purpose of money laundering and financing terror.

3. Organizational Structure, Duties and Authorities of Risk Management

Supervision of risk management system at the Bank shall be carried out by the Risk Management Committee and the Board of Directors. Reporting directly to the Bank’s Supervisory Board and carrying out its activity independently, the Risk Management Committee shall carry out the following duties within its authorities:

- set minimum requirements related to each phase of the risk management process;

- give instructions to the risk management department and request regular reports from them;
- assess the risk management department's work (Risk management department's work shall also be assessed by the internal audit section of the Bank) and provide report to the Supervisory Board about its results;
- set limits calculated by the risk management department for different risks, and submit to the Supervisory Board for approval;
- provide regular reports to the Supervisory Board on the condition of risks the Bank was subjected, adequacy of the risk management system and efficiency of the risk management process;
- assess the intra-bank risk management system's function, review the rules and methodologies for various directions of transaction and activity and risk management policy, and provide relevant recommendations to the Supervisory Board.

Day-to-day activity of the risk management system shall be arranged by risk management department. The Department's structure shall be defined by the Bank's organizational and management structure, and shall consist of the following sections:

- Economic analysis and risk management section;
- Market and liquidity risks management section;
- Transaction risks management section.

Risk management section at the Bank shall perform the following duties within its authorities:

- draft internal rules for risk management and review them on a regular basis;
- determine the content of data required from other structural divisions with the objective of carrying out the risk management process, and collect such data;
- analyse the data received and determine risks in various spheres, and periodically assess such risks;
- provide regularly information of the risks and their trends, as well as their monitoring and supervision to the Risk Management Committee (RMC) and the Board of Directors;
- provide periodical reports to RMC and the Board of Directors reflecting the results achieved in various stages of the risk management process;

- carry out regular study of the international practice on innovations in the sphere of risk management, prepare recommendations and provide them to RMC and the Board of Directors;
- calculate limits on all types of transactions and provide recommendations on relevant changes related thereto to RMC and APIK;
- develop an emergency plan together with other structural divisions of the Bank and, after being approved by the Supervisory Board, inform every employee, whose participation in removing emergency situations is deemed necessary, thereof;
- carry out supervision over observance of requirements related to quantitative and qualitative indices of the bank capital and capital's adequacy;
- provide methodical assistance to all sections of the Bank in management of risks, as well as hold internal seminars of the Bank with the objective to acquaint the employees with the policies and rules adopted on management of risks;
- conduct inquiries at all levels of the Bank;

4. Management of Credit Risks

Management of credit risks shall be carried out based on the requirements of the Central Bank of Azerbaijan on management of credit risks, appropriate principles defined by the Basel Committee, as well as other standards adopted at an international level.

Management of credit risks shall consist of the following stages:

- establishment of credit risks;
- assessment of credit risks;
- monitoring of credit risks and reporting;
- supervision of credit risks.

The following analytical methods based on qualitative and quantitative indices shall be used to manage credit risks at the Bank:

- analysis of credit risks based on "Value subjected to risk" model;
- calculation of credit risks based on the "Total risk level";
- calculation of credit risks based on "Value subjected to default";

- assessment of credit portfolio based on an analytic method;
- assessment of credit portfolio through a statistic method.

Also a system of limits is applied at the Bank in settlement of credit risks. Application of the system of limits is essential from the standpoint of minimizing credit risks. The following types of limits exist on settlement and supervision of credit limits:

- maximum amount of credit on each type, and concentration of credits on the types;
- relation of the total volume of credits to the volume of deposits;
- relation of the total volume of credits to the total amount of deposits and other funds attracted;
- maximum amount of credit on one debtor and a group of debtors associated with each other, and concentration of such credits;
- concentration of credits on geographical location, including concentration in one country or group of countries having close relationship;
- concentration of credits on basic types of credits;
- maximum amount of credit given to related persons, and concentration of such credits;
- concentration of credits on the status of debtors (legal and natural persons and natural persons being engaged in entrepreneurship without establishing a legal person);
- concentration on the type of security (real estate, securities etc.);
- concentration of credits with the same payment terms;
- concentration of credits with the same guarantor;
- concentration of non-active credits;
- maximum amount of blank credits and concentration of such credits;
- maximum amount of credits given by a branch, and concentration of such credits (in case a branch was given permission on such transactions)
- establishment of limits on customers and products.

5. Management of Market and Liquidity Risks

A collection of indices defining the Bank's direction of activity are used in order to fully discover and assess the signs of emergence of market and liquidity risks.

The process of managing market risks shall consist of the following stages:

- Establishment of the market risks;
- Assessment of the market risks, including interest, currency, capital and commodity risks;
- Monitoring of the market risks, and reporting;
- Supervision of the market risks.

The following methods of assessment and analysis are applied in management of the market risks at the Bank:

- Calculation and analysis of interest rate risk based on the "GAP" method;
- Calculation and analysis of interest rate risk based on the "Duration GAP";
- Calculation and analysis of "Value subjected to Risk" (VSR) model;
- Analysis of assets and liabilities on payment terms;
- Calculation and analysis of an open currency position;
- Conducting stress-tests on assessment of interest rate risk, and analysis of results.

The objective of managing liquidity risk is to ensure that liabilities arising from transactions carried out with the Bank's financial tools are performed timely and in full.

For the analysis of the liquidity risk at the Bank, analyses on the following liquidity indices are carried out:

- Calculation and analysis of instant liquidity index;
- Calculation and analysis of current liquidity index;
- Calculation and analysis of long-term liquidity index;
- Calculation and analysis of assets and liabilities on payment terms using the "GAP" method;
- Holding stress-tests on assessment of liquidity, and analysis of the results.

In order to efficiently regulate market and liquidity risks and keep them at an acceptable level, the Bank uses appropriate set of actions and tools.

6. Management of Transaction Risks

Purpose of managing transaction risks is to keep the risks undertaken by the Bank at the level defined according to the strategic targets.

The process of risk management at the Bank consists of the following stages:

- Estimation of transaction risks;
- Assessment of transaction risks;
- Monitoring of transaction risks, and reporting;
- Supervision of transaction risks.

The stage of estimating transaction risk at the Bank covers the process of discovering information on the transaction risks and losses occurred on the defined risk categories and those expected. Establishment of transaction risks occurred and expected at the Bank shall be carried out using the following methods based on the international practice:

- Inquiries sent to the Bank's structural divisions;
- Organization of interviews with heads of the Bank's structural divisions and employees;
- Giving recommendations on the analysis of business processes and their optimization;
- Collection of information on material losses arisen as a result of transaction risks in the Bank's accounting documents;
- Assessment of internal rules from the standpoint of transaction risk.

With the objective of effective management and assessment of transaction risks, information about the transaction risks the Bank was subjected to shall be recorded in the analytic data system.

In addition, with the objective of defining the likelihood of transaction risks level and preventing them in good time, as well as effective management thereof, the Bank uses a Main risk indices system carrying out the function of early warning on individual categories of transaction risks, and regular monitoring of main risk indices created in the Bank's business processes and their supervision ensured.

There is also in place an Emergency plan based on the international practice, which is aimed at ensuring the Bank's uninterrupted activity. The current plan is a collection of rules defining the algorithm of correct actions depending on the human factor (terror, strikes etc.), during anthropogenic events (power cut, shortages in IT systems' work etc.) and natural disasters (fire, flood, tornado etc.), which in turn is aimed at keeping losses at a minimum level and restoration of operation in a short span of time.