

Approved by the Decree of the
President of the Republic of Azerbaijan
№ 511 dated June 19, 2001

RULES ON MANAGEMENT OF FOREIGN CURRENCY ASSETS OF THE STATE OIL FUND OF THE REPUBLIC OF AZERBAIJAN

Including the addendums and amendments according to the Decrees of the President of the Republic of Azerbaijan № 607 dated December 21, 2001, № 202 dated March 1, 2005, № 216 dated February 10, 2010, № 519 dated October 27, 2011, № 1376 dated May 12, 2017 and № 450 dated 28 December 2018

1. GENERAL PROVISIONS

- 1.1. These Rules are prepared in accordance with the “Statute of the State Oil Fund of the Republic of Azerbaijan” approved by the Decree of the President of the Republic of Azerbaijan № 434 dated December 29, 2000 and determine the arrangements for allocation and management of the foreign currency assets of the State Oil Fund of the Republic of Azerbaijan (hereinafter referred to as the Oil Fund).
- 1.2. The purpose of management of the Oil Fund’s foreign currency assets in accordance with these Rules is to hold those assets securely and increase their value by means of efficient management.
- 1.3. For the objectives of these Rules, the term “foreign currency assets of the Oil Fund” (Investment Portfolio) should mean reserves denominated in foreign currency, except for converted and transferred to manat accounts expenditures approved within the framework of the main directions (program) of utilization of the Oil Fund’s assets and expenditures related to the management of the Oil Fund. The total value (weighted average size) of the investment portfolio is determined on the basis of the monthly revaluation of assets included in the Oil Fund’s investment portfolio.

2. CREDIT QUALITY AND CURRENCY COMPOSITION REQUIREMENTS FOR THE INVESTMENT PORTFOLIO OF THE OIL FUND

2.1. Credit quality requirements for the Investment Portfolio of the Oil Fund

2.1.1. Correspondent accounts of the Oil Fund for foreign currency assets in the Republic of Azerbaijan should only be opened at the Central Bank of the Republic of Azerbaijan.

2.1.2. Correspondent accounts of the Oil Fund outside the Republic of Azerbaijan (abroad) should be opened at the banks with a long-term credit rating of not less than:

“A-” based on Standard & Poor’s credit rating scale

“A3” based on Moody’s credit rating scale

“A-” based on Fitch credit rating scale

The threshold credit rating for foreign correspondent banks is:

“A-” based on Standard & Poor’s credit rating scale

“A3” based on Moody’s credit rating scale

“A” based on Fitch credit rating scale

In the event, the long-term credit rating of an abovementioned bank is downgraded and below threshold level, the Oil Fund will initiate a transfer of the Oil Fund’s assets to another bank with a long-term credit rating consistent with threshold requirements within a reasonable period of time.

2.1.3. The counterparties of the Oil Fund in the international financial markets should be commercial banks and other financial institutions with long-term investment grade credit ratings (Standard & Poor’s, Fitch or Moody’s).

The counterparties in the domestic financial market should be amongst the largest commercial banks by the level of capital or the most reputable ones based on their credit rating. Maximum capital, allocated to those banks should not exceed 5% of the total value.

2.1.4. Custodian (depository) services for securities are provided to the Oil Fund by central (national) banks, commercial banks and other financial institutions with long-term credit ratings of not less than:

“A-” based on Standard & Poor’s credit rating scale

“A3” based on Moody’s credit rating scale

“A-” based on Fitch credit rating scale

The threshold credit rating for financial institutions providing custodian services to the Oil Fund is:

“A-” based on Standard & Poor’s credit rating scale

“A3” based on Moody’s credit rating scale

“A” based on Fitch credit rating scale

In the event, the long-term credit rating of such an institution is downgraded and below the threshold level for more than 60 calendar days, the Oil Fund will substitute it for other banks or financial institutions with a long-term credit rating consistent with threshold requirements within a reasonable period of time.

2.1.5. Holding or placement of foreign currency assets of the Oil Fund is carried out on the basis of appropriate contracts.

2.1.6. If the credit rating of the assets included in the Investment Portfolio or of the banks and other financial institutions where foreign currency assets of the Oil Fund are placed, is downgraded and continuously remains below the appropriate rating considered by these Rules for more than 90 calendar days, the Oil Fund will transfer those foreign currency assets to institution with an appropriate rating that comply with the requirements of these Rules, or remove (sell, exchange and etc.) the asset from the portfolio, as applicable.

2.1.7. In accordance with the instances mentioned in the eighth subparagraph of paragraph 3.3 of these Rules, counterpart banks and other financial institutions in international financial markets that provide depository services, where foreign currency assets of the Oil Fund are placed, may have non-investment grade credit rating (not less than B-” (Standard & Poor’s, Fitch) or B3” (Moody’s)).

3. MANAGEMENT OF THE OIL FUND'S INVESTMENT PORTFOLIO

3.1. Asset management framework

3.1.1. Management of the Oil Fund's Investment Portfolio should be implemented in accordance with its investment policy adopted each year.

3.1.2. The investment policy of the Oil Fund is to be prepared by the Executive Director of the Oil Fund in a manner that complies with the program on the main directions of utilization of the assets of the State Oil Fund and submitted to the President of Republic of Azerbaijan for approval along with the opinion of the Supervisory Board.

3.1.3. Financial institutions that are qualified as investment managers (hereinafter, external managers) may be involved in the management of a certain part of the Investment Portfolio of the Oil Fund (hereafter, externally managed portfolio). Requirements for external managers and size of managed portfolio are defined in Oil Fund's Investment policy.

3.1.4. The following general principles and directions of the Investment Portfolio management should be reflected in the Oil Fund's investment policy:

- The forecasted size of the Investment Portfolio;
- If applicable, requirements with respect to external manager(s) including size of the portfolio under management and management period;
- Liquidity and interest rate risk requirements;
- Credit risk limits;
- Investment Portfolio benchmarks and target returns;
- The composition and breakdown of Investment Portfolio by asset classes and currencies.

3.1.5. The Executive Director of the Oil Fund defines the internal procedures of the Oil Fund and makes arrangements for the allocation and management of the foreign currency assets of the Oil Fund in accordance with the investment policy of the Oil Fund and these Rules.

- 3.1.6. Division of activities and responsibilities, internal controls and accurate accounting systems should be applied, in order to minimize operational risks associated with Investment Portfolio.
- 3.1.7. Deal execution, confirmation (cancellation) and settlement as well as accounting and reporting operations associated with the aforementioned activities, should be implemented by the relevant departments or officials of the Oil Fund with clear division of the responsibilities.
- 3.1.8. The Oil Fund should have internal controls for adhering to these Rules, insuring proper division of responsibilities, and implementing operational procedures.
- 3.1.9. The professional behavior of the officials and employees of the Oil Fund should comply with ethical norms and rules of the International Financial Markets Association (ACI, Paris) and in no case may personal interest be in a conflict with duty to the Oil Fund.

3.2. Risk management

In order to mitigate the risks in the management of the Oil Fund's foreign currency assets, limits are defined in the investment policy of the Oil Fund based on the following criteria and in the following sequence:

Credit risk - i.e. the maximum weight that can be allocated to one issuer and/or holding, and the credit rating threshold for an issuer and/or holding;

Liquidity risk - i.e. maximum duration of the Investment Portfolio and minimum liquidity for specific periods;

Market risk (currency and interest rate risk) as well as the maximum weight of each currency included in the Investment Portfolio and the investment assets denominated in these currencies and the duration of the Investment Portfolio.

3.3. Allocation of foreign currency assets (investment directions)

By not prejudicing items 2.1 and 3.4 of these Rules, Oil Fund's Investment Portfolio, which is divided into corresponding sub-portfolios in accordance with the Oil Fund's Investment Policy, may include the following assets:

- Deposits in the central (national) banks, commercial banks and other financial institutions;
- Debt obligations issued by the governments, government agencies, international financial organizations, for profit organizations and other institutions with long-term investment grade credit ratings (Standard & Poor's or Fitch or Moody's);
- Debt obligations with long-term investment grade credit ratings (Standard & Poor's or Fitch or Moody's) issued by governments, government agencies, international financial organizations, for profit organizations and other institutions;
- Investments in stocks included in major international equity indices;
- Share of mutual and alternative investment funds that invest in stocks, debt obligations without credit rating, and real estate;
- Gold bars conforming to the requirements of the London Bullion Market Association;
- Real Estate;
- Non-investment grade debt obligations or deposits of which up to 1% should be with credit rating of not less than "B-" (Standard & Poor's or Fitch) or "B3" (Moody's), and the rest investments should be with credit rating of not less than "BB-" (Standard & Poor's or Fitch) or "Ba3" (Moody's). Maximum capital, allocated to those investments should not exceed 5% of the total value.

3.4. Limitation on investment directions

3.4.1. Foreign currency assets of the Oil Fund cannot be invested in other asset classes and except for the assets considered in item 3.3. of these Rules and necessary operations for their acquisition (selling).

3.4.2. Derivatives (i.e. swaps, forwards, futures, etc) may be used for hedging or optimizing the currency composition and asset allocation of the Investment

Portfolio.

4. REPORTING ON INVESTMENT PORTFOLIO MANAGEMENT

- 4.1. Quarterly statements and annual report with relevant information regarding Oil Fund's Investment Portfolio (volume, structure and forecasted inflows and outflows) is submitted to the Supervisory Board of the Oil Fund and the President of the Republic of Azerbaijan.
- 4.2. In the course of preparation of the report on the management of foreign currency assets, the performance of foreign currency assets of the Oil Fund should be calculated in accordance with the Fund's currency basket.