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Azerbaijan: Financial Sector Assessment

Jurgen F. Conrad

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Unless otherwise noted, $ refers to US dollars.

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CURRENCY EQUIVALENTS
(as of 15 December 2012)

Currency Unit	=	manat (AZN)
AZN1.00	=	1.2737
$1.00	=	0.7851

ABBREVIATIONS

ADB	-	Asian Development Bank
AIG	-	American International Group
AMF	-	Azerbaijan Mortgage Fund
AMFA	-	Azerbaijan Microfinance Association
ATM	-	automated teller machine
BSE	-	Baku Stock Exchange
BSTDB	-	Black Sea Trade and Development Bank
DEG	-	Deutsche Investitions und Entwicklungsgesellschaft (German Investment Corporation)
EBRD	-	European Bank for Reconstruction and Development
GDP	-	gross domestic product
IBA	-	International Bank of Azerbaijan
IFC	-	International Finance Corporation
KfW	-	Kreditanstalt für Wiederaufbau
NPL	-	nonperforming loan
SCS	-	State Committee for Securities
SECO	-	State Secretariat for Economic Affairs
SFDI	-	Social Fund for Development of Internally Displaced Persons
SMEs	-	small and medium-sized enterprises
OTC	-	over the counter
USAID	-	United States Agency for International Development

NOTE

In this report, “$” refers to US dollars.

CONTENTS

I. EXECUTIVE SUMMARY

Bolstered by strong hydrocarbon export revenues, the Government of Azerbaijan has been able to substantially increase budget expenditure in recent years. This has boosted growth in economic sectors outside oil and natural gas, and expanded opportunities for the country's financial institutions, which cater mainly to non-hydrocarbon sectors. Even so, total financial sector assets represent just 31% of gross domestic product (GDP), falling well short of the financial sector's potential to contribute to economic growth through savings mobilization and investment financing. Nonbank financial services may provide a particularly strong area for development, with banks still accounting for 93% of financial sector assets.

Financial sector development did suffer setbacks during the 2008–2009 global financial crisis. However, Azerbaijan's banks avoided serious damage, due to their limited exposure to credit from abroad, state support through banks for infrastructure projects, and direct state-support for large borrowers with payment difficulties. The sector has now entered the post-crisis period, with bank credit growing and the securities markets reviving. Growth is particularly strong in microfinance and insurance, albeit from a low base.

Banking. Most of Azerbaijan's 44 banks are small. The exception is the remaining state-owned bank, International Bank of Azerbaijan (IBA), which still accounts for 34% of banking sector assets. The privatization of IBA is under consideration but concrete plans have yet to be announced. While 23 banks have some foreign shareholding only 5 are majority foreign owned. Together, they account for about 10% of sector assets. Foreign investment has so far come mainly from international financial institutions, and from the Russian Federation, Turkey, and the Middle East. High interest rate margins suggest that the efficiency of the Azerbaijan's financial sector can be further increased. The main constraints are market segmentation that results from special relations between banks and current or former government officials, and groups of private or state-owned enterprises; a difficult business climate marked, among other things, by weak rule of law, which increases risks for banks; and, to a degree, IBA's strong market position, which makes it difficult for other banks to realize economies of scale.

Banking sector assets are equivalent to 29% of GDP, while loans account for 67% of assets, and loans to households and service sectors together account for 55% of total loans. Banks are also heavily involved in project finance. On the liability side, the sector has avoided overdependence on foreign borrowing, benefiting instead from government funding programs. Such programs partly explain the high share of long-term loans in total loans (71%) and the strong increase in mortgage lending over recent years. Customer deposits account for 47% of assets. This is high by regional standards. However, there remains considerable room for deposit mobilization.

While banking sector stability does not seem at risk in the short to medium term, the operational environment for banks remains sensitive to external shocks, such as a sharp decline in hydrocarbon export prices. Against this backdrop, banks need to continue efforts to improve asset quality, strengthen liquidity, develop deposit bases, and diversify funding sources. Banking legislation and regulation have improved over recent years, but weaknesses remain, particularly in corporate governance, single-borrower exposure, related-party lending, loan classification, consolidated supervision, and cross-border banking supervision. Furthermore, the strong political connections of some banks might constrain enforcement of banking regulation and supervision.

Banking sector outreach has substantially improved over recent years, as reflected in a sharp rise in the number of branches, accounts, and automated teller machines (ATMs). However, much remains to be done, such as increasing the number of savings accounts and making better use of electronic payments. In the area of gender outreach, men are more likely to use financial services (60%), but women are somewhat more likely to use loans (53%). However, 41% of the loans taken out by women are consumer loans, compared with 37% for men.

Microfinance. This has grown strongly in Azerbaijan, with borrowers rising from 100,000 in 2006 to more than 400,000 by 2011. Even so, microfinance has not yet reached its potential. The combined microfinance loan portfolio of nonbank financial institutions and banks is still only about 1% of GDP, despite considerable demand for microfinance services. Sector concentration is high, with the two largest providers of microfinance, Accessbank and FINCA, together accounting for 46% of the market. The legal and regulatory environment for microfinance organizations is relatively new and needs substantial improvement, including in the key area of capacity building for supervision. Credit unions, meanwhile, still largely depend on external credit lines rather than member shares and deposits, which raises sustainability concerns.

Insurance. Azerbaijan's insurance sector comprises 28 companies, many of which are linked to banks. Sector segmentation is high and competition limited. The market share of foreign institutions is still low at around 7%, but two large foreign insurers are now present. The government has started to support the sector by strengthening the enabling environment and introducing mandatory insurance. But at this stage of the sector's development, total assets account for just 0.8% of GDP and property insurance remains the dominant insurance product.

Securities markets. Although small, Azerbaijan's securities markets do contribute to capital mobilization. About 250 companies have more than 100 shareholders. Some of them issue securities on a regular basis, even if listing remains underdeveloped and the secondary markets are narrow and illiquid. In 2011, companies issued shares equivalent to 2% of GDP through 142 issues; banks accounted for 14% of the volume. In addition, capital raised through a total of 101 corporate bond issues amounted to 1.2% of GDP. State-owned Azerbaijan Mortgage Fund was the largest issuer, followed by a number of private financial institutions. The basic institutional framework for the securities markets has been in place for more than a decade. The authorities are now strengthening it under the State Program for the Development of Securities Markets for 2011–2020 with World Bank support, alongside measures to strengthen the legal and regulatory framework.

Possible areas for assistance. Given the improvements in banking, the focus of financial assistance might have to gradually shift in coming years from banks to nonbank financial services. At this stage, however, banks still need support, particularly through equity capital and for the introduction of new products. The privatization of IBA might also require support.

In the areas of regulation and supervision, the authorities see a financial sector assessment by the International Monetary Fund and World Bank scheduled for 2014 as an opportunity for identifying remaining weaknesses. Later, the broader donor community may need to provide support in these areas. However, it is already clear that regulation and supervision of nonbank financial institutions and insurance companies need to be substantially strengthened. Azerbaijan has no "lead donor" in these two areas.

In the area of knowledge products, the government might also be interested in learning how to improve the efficiency of intermediation of public resources through financial institutions into the economy. Ways to further reduce dollarization might be of interest and great value for financial (and private) sector development too.

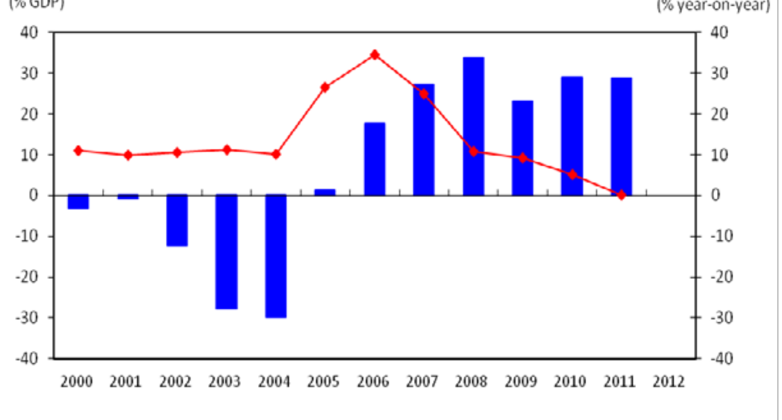
Since Azerbaijan's business climate remains an issue for financial institutions, reforms in this area would likely have a strong direct positive impact on financial sector development.

II. INTRODUCTION

1. Azerbaijan's economy is heavily reliant on natural gas and oil, with hydrocarbon production and related services accounting for about 60%–70% of GDP. Because the state exercises a high degree of control over this sector, hydrocarbon export revenues have enabled the government to substantially increase budget revenues and expenditure. This has boosted growth in other sectors of the economy and created business opportunities for financial institutions, which cater mainly to non-hydrocarbon businesses. However, the development potential of Azerbaijan's financial sector remains unmet. In other words, the financial sector does not yet contribute to the degree possible to economic growth through savings mobilization and investment financing. This should change, ideally before oil production peaks sometime around 2015.

2. Economic growth accelerated strongly in 2003 with the onset of an ongoing oil boom (Figure 1). In 2003–2008, annual GDP growth averaged 20%, with growth initially driven by investment in the hydrocarbon sector, and later by large export surpluses. Azerbaijan's current account balance, chronically negative until 2004, turned positive in 2005 and increased to $16.5 billion or 34% of GDP in 2008.

Figure 1: Economic Growth and Current Account



GDP = gross domestic product.

Source: International Monetary Fund.

3. The effect of the global crisis, felt mainly through falling hydrocarbon export prices, was mitigated by increased oil production and a strong fiscal stimulus for the non-hydrocarbon sectors. The stimulus was easily financed from fiscal buffers built before the crisis. As a result, economic growth stabilized at around 10% in 2008–2009. With only minor changes in oil production, it slid to 5% in 2010 and 0.1% in 2011. Non-hydrocarbon growth was higher, reaching 7.9% in 2010 and 9.4% in 2011. Monetary stability was preserved throughout, although consumer prices were susceptible to global food and commodity price fluctuations (Figure 2). In 2012, GDP growth accelerated again. From a macroeconomic standpoint, Azerbaijan has entered the post-crisis period.

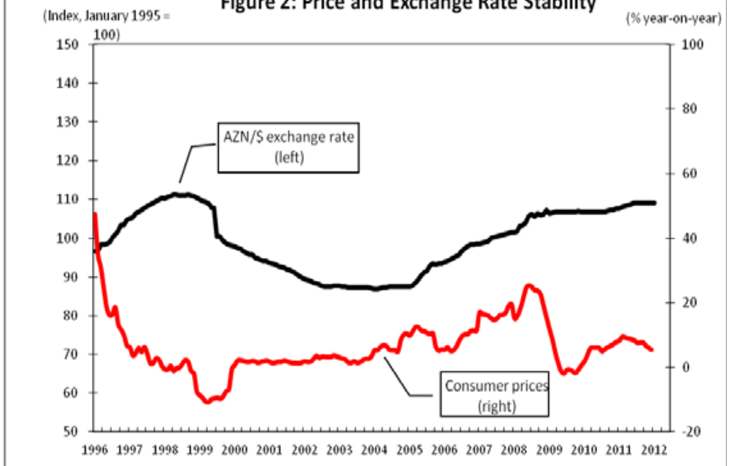
4. The same applies to the financial sector, the performance of which is closely aligned to the non-hydrocarbon sectors of the economy. Most financial institutions coped relatively well with the global crisis, mainly because of their limited exposure to credit from abroad, state support through banks for long-term infrastructure projects, and direct state-support for large borrowers with payment difficulties. Sustained exchange rate stability and the broadening of deposit insurance were also helpful in light of high dollarization and the risk of deposit runs.[1] Asset quality problems have increased due to the economic slowdown, but most financial institutions are sufficiently capitalized and have the earning capacity to absorb losses. In short, while the financial sector has not yet fully regained its precrisis position, the focus can move from crisis management to addressing the long-term challenges of financial sector development.

[1] High dollarization is the result of hyperinflation in the early 1990s and the high amount of revenues in US dollars from hydrocarbon exports.

III. SECTOR PERFORMANCE, PROBLEMS, AND OPPORTUNITIES

5. Despite progress, financial intermediation remains low in Azerbaijan. The ratio of broad money to GDP, a broad intermediation measure, has doubled to 28%, after stagnating below 15% over the first half of the last decade. Yet, this is still low from a regional and global perspective. This cannot be primarily explained by monetary factors, given the relatively high degree of price and exchange rate stability over the past 15 years (Figure 2).[2] So the reasons for this must mainly be structural.

Figure 2: Price and Exchange Rate Stability



Source: International Monetary Fund.

6. Total assets of the country's financial institutions more than doubled from about 14% of GDP in 2000 to 35% in 2009. Most of the growth took place in the second half of this period. Subsequently, sector assets declined to 31% of GDP in 2011 due to spillover from the global financial crisis. Nevertheless, even an asset-to-GDP ratio of 35% would not be high by regional standards for a country of the size and income level of Azerbaijan (Table 1). The larger an economy, the more financial institutions should benefit from scale economies. Furthermore, rising incomes imply increasing demand for financial services. Higher per capita GDP is, therefore, usually associated with more developed financial markets. All this suggests that Azerbaijan, with its sizable economy and relatively high GDP per capita, still has considerable potential for financial sector development.[3]

Table 1: Income and Financial Intermediation in Selected Countries (2011)

	GDP ($ billion)	Population (million)	GDP per capita ($)	Broad Money (% of GDP)	Bank Assets (% of GDP)	Financial Sector Assets (% of GDP)
Central and West Asia						
Kazakhstan	186.4	16.7	11,260	35.7	47.0	62.6
Azerbaijan	**63.2**	**9.0**	**6,990**	**27.8**	**28.5**	**30.6**
Uzbekistan	45.3	28.8	1,570	23.0	35.3	n.a.
Turkmenistan (2010)	20.1	5.1	3,940	31.3	30.1	n.a.
Georgia	14.4	4.5	3,220	29.3	52.3	56.5
Armenia	10.1	3.3	3,100	29.8	54.7	58.6
Tajikistan	6.5	7.8	830	20.9	27.6	30.9
Kyrgyz Republic	5.8	5.6	830	27.8	24.4	30.9
Other regions						
Russian Federation	1,785.0	139.9	12,760	51.7	76.3	85.0
Turkey	773.0	75.7	10,210	54.9	81.0	105.0
Ukraine	165.2	45.5	3,610	52.1	80.1	85.5

n.a. = not available
Sources: International Monetary Fund, World Bank, national financial sector regulatory bodies.

2 The first half of the 1990s, however, was characterized by hyperinflation and exchange rate instability.
3 Azerbaijan's per capita GDP was below $1,000 until 2004. The subsequent substantial increase should provide a strong basis for financial sector development in the medium term.

A. Banking

7. **Structure and ownership**. The number of banks declined sharply from over 250 in the early 1990s to 46 in 2003 and 44 in 2011. The drop was due mainly to efforts by the authorities to consolidate the sector by strengthening regulation in general, and by increasing minimum capital requirements in particular. As a result, only two banks now have capital of less than $12.5 million equivalent, the required minimum. Nevertheless, most banks remain small, with market shares of less than 1% and only a few with shares up to 6%. State-owned IBA, the only exception, has lost market share in recent years, but still accounts for 34% of sector assets.[4] Only IBA and, to a lesser degree, Kapital Bank, which is crucial for the payment system, have systemic importance (Table 2).[5] IBA's strong position still somewhat distorts competition. However, the close ties many banks seem to have with current or former government officials and groups of enterprises are more serious constraints to the sector's development.

8. The authorities seem interested in further sector consolidation, but have announced no plan for this, and the total number of banks remained largely unchanged over the past decade.[6] Indeed, opportunities might have been missed during the global crisis and beyond to apply the bank resolution framework and shut down weak institutions.[7] Voluntary mergers have not happened, as most banks have their specific culture and client orientation.

9. In 2011, the government revived long-time efforts to privatize IBA by asking PricewaterhouseCoopers to develop a privatization plan by mid-2012. This plan has not yet been disclosed.

10. Before IBA can be privatized, the following issues need to be addressed. First, IBA has historically been undercapitalized and struggles with asset quality problems, mainly because of losses in the Russian Federation during the global crisis. The authorities are now solving or at least substantially mitigating these issues through a capital injection of $300 million equivalent, which the government announced in February 2012.[8] Second, in the interests of sound sector competition, possible future private owners of IBA should not enjoy a dominant market position. This means IBA needs to further downsize. This could be achieved by giving other banks the opportunity to participate or increase their participation in government lending programs and attract more deposits from government organizations and state-owned enterprises. Third, IBA's lending activities partly serve government policy purposes. This could be addressed by establishing a specialized development bank.

11. Foreign investment has already helped increase the competitiveness of individual banks. However, its impact on the system has been limited, perhaps because of its modest scope. Twenty-three banks have some foreign shareholding, nine of which are majority foreign owned.[9] However, these nine account for only about 10% of sector assets, which is low by regional standards. And investment has so far come mainly from international financial institutions, the Russian Federation, Turkey, and Middle Eastern countries.

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[4] The government's direct shareholding in IBA stood at 51% before the capital injection announced in early 2012. The balance is held by individuals and legal entities, some of which also have state-shareholding.

[5] According to Central Bank of Azerbaijan's own methodology, 12 banks have systemic importance.

[6] Several banks lost their licenses, but eight new banks were licensed in 2005–2011.

[7] A recent case in point is Technika Bank, which faced serious problems and was brought under the management of an IBA team in May 2012. This was done rather than expose it to the bank resolution framework.

[8] The government and current minority shareholders will each inject AZN50 million by the end of 2012. The government will also provide AZN150 million as subordinated debt (quasi-capital).

[9] In addition, five foreign banks have representative offices in Baku: Citibank, Commerzbank, Société Générale, Parex Bank from Lithuania, and Rosselkhozbank from Russia.

Table 2: Leading Commercial Banks

Name	Ownership	Assets (AZN million)[a]	Other Information
International Bank of Azerbaijan (IBA)[b]	Majority state (51%)	5,229	Former Soviet foreign trade bank
Kapital Bank[b]	Private domestic (Pasha holding)	991	Former Soviet savings bank Traditionally a passive lender
Xalq Bank[b]	Private domestic	801	Mainly corporate customers
Bank Standard	Private domestic (AB Standard group)	726	Founded in 1995, initially a retail bank, now mainly corporate banking
Pasha Bank	Private domestic (Pasha Holding)	625	Holding includes banks, insurance companies, and construction firms
Technika Bank[b]	Private domestic (through offshore fund)	576	Old management removed in 2012. Now managed by team from IBA
Unibank[b]	Minority foreign (DEG 8.3%, EBRD 15.2%)	460	Incorporated in 2002 through merger of M-Bank and Promtechbank
Accessbank	Majority foreign (EBRD, IFC, KfW, BSTDB, LfS Financial Systems)	391	Established in 2002 as green field Microfinance Bank. Leading provider of micro-loans
Demir Bank	Minority foreign (EBRD 25%, Dutch Development Finance Company 10%)	358	Founded in 1989. Focus on SMEs and individuals
Bank Respublika[b]	Minority foreign (DEG 16.7%, SIDT 8.3%)	340	Mainly retail banking
Bank of Baku[b]	Private domestic	339	Seen as leading retail bank, as well as active in SME business. Strong in regions.
AG Bank	Minority foreign (IFC 17.5%, US investor)	321	Former Azerigaz Bank
Muganbank	Private domestic	249	
AtaBank	Private domestic (Ata Holdings)	231	
Zaminbank	Private domestic	225	Passive lender
Yapi Kredit Bank	Majority foreign (Turkey, Unicredito)	221	Focus on Turkish investors and foreign trade

BSTDB = Black Sea Trade and Development Bank, DEG = German Investment Corporation; EBRD = European Bank for Reconstruction and Development, KfW = Kreditanstalt für Wiederaufbau, IFC = International Finance Corporation, SMEs = small and medium-sized enterprises.

[a] April 2012

[b] Rated by Moody's Investors Service.

Sources: Central Bank of Azerbaijan, expert interviews, media reports.

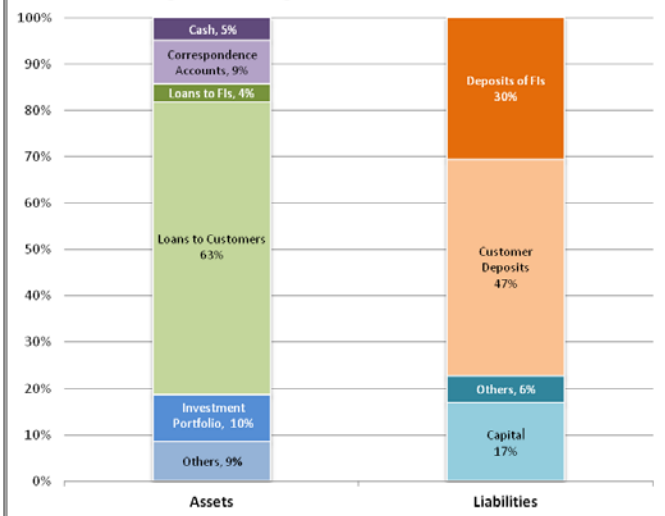
12. **Intermediation**. Banking sector assets are equivalent to 29% of GDP (end of 2011), down from their peak of 34% in 2009. Loans account for 67% of assets (Figure 3); this ratio has hardly changed over the past 5 years. At 71%, the share of long-term loans in total loans is relatively high, and about one-third of long-term loans is funded by the government through the central bank. Household loans account for 32% of total loans: 70% of household loans are consumer loans, 17% mortgage loans, 8% loans to individual entrepreneurs, and 5% credit card loans. The share of mortgage loans has doubled over the past 5 years at the expense of consumer loans and loans to individual entrepreneurs.[10] Mortgage loans have an average maturity of 22.5 years and an average nominal interest rate of 6.9%. Trade and services account for 25% of banks' loan portfolio, and mining and energy for another 11%. The

[10] Mortgage lending has rocketed due to refinancing by the state-owned Azerbaijan Mortgage Fund.

remaining 32% are almost equally divided between agriculture, construction, industry, and transport. The overall impression is that the mining sector, which dominates the economy, does not need much support from domestic banks, which instead focus lending activities on households and service sectors. Quantitative information about bank lending to small and medium-sized enterprises (SMEs) is not available.[11]

13. In terms of liabilities, banks have been successful by regional standards in mobilizing domestic deposits to finance their lending activities. That has helped banks avoid overdependence on foreign borrowing. Customer deposits account for 56% of sector liabilities (and 47% of assets), of which household deposits account for 35%. These ratios have been growing strongly over recent years, despite the impact of the global financial crisis. The introduction of deposit insurance in 2008 with steep requirements for participating banks and the broadening of its coverage in 2009 helped avoid major setbacks.[12] However, household deposits are still equivalent to just 8% of GDP. This suggests that there is considerable room for further deposit mobilization, particularly given the substantial amount of cash in circulation. Cash outside banks is equivalent to three-quarters of deposits.

Figure 3: Banking Sector Assets and Liabilities



Source: Central Bank of Azerbaijan.

14. External borrowing accounts for another 16% of bank liabilities. It consists largely of short-term trade finance provided by foreign banks (mainly to IBA), complemented by credit-lines from international financial institutions (mainly to private banks). The balance consists of central bank credits and interbank liabilities. Central Bank of Azerbaijan funding has increased over recent years, but only a fraction of it has been provided through short-term, emergency facilities. Most central bank loans are essentially government funds for long-term infrastructure projects.[13] Central bank loans therefore have unusually long maturities and are typically collateralized by guarantee letters from the Ministry of Finance. This approach helps intermediate hydrocarbon export revenues, which accrue in government coffers, into non-hydrocarbon sector investments. The approach has partly compensated banks for their lack of access to the long-term funds that could be attracted through issuing securities in domestic and international markets.[14] In addition, the monetary authority provides direct loans to enterprises.[15] Altogether, the Central Bank of Azerbaijan is estimated to account for as much as 17% of domestic lending in Azerbaijan, half of this provided through banks.

[11] There are more than 80,000 registered small enterprises in Azerbaijan, with maximum staff numbers of less than 50 in industry, less than 25 in agriculture, less than 15 in wholesale trade, and less than 10 in other economic sectors. There are also more than 333,000 individual entrepreneurs.

[12] In response to weakening depositor confidence, the amount covered by the Azerbaijan Deposit Insurance Fund, established in 2007, was increased from AZN6,000 to AZN30,000 ($38,000) per individual in early 2009. The fund currently insures more than 60% of the total amount of individual deposits. Its assets are equivalent to only $50 million, a fraction of total insured deposits. In a systemic crisis, the fund might need government support.

[13] Such infrastructure funding was massively increased during the crisis to serve as fiscal stimulus to the economy.

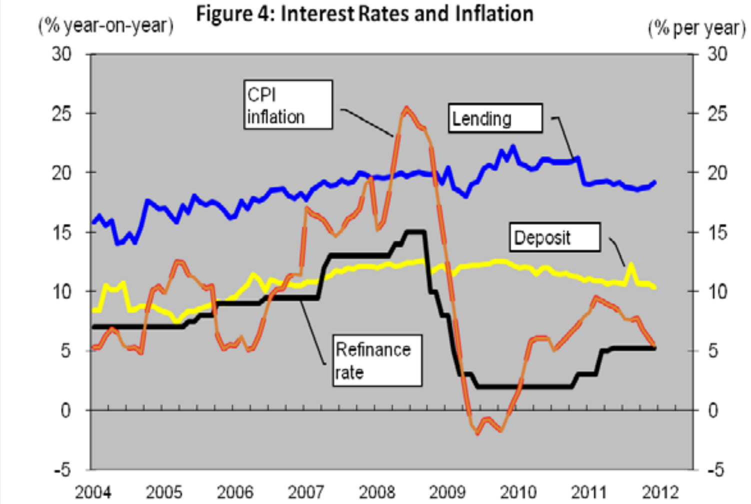
[14] Azerbaijan banks have been issuing securities in the domestic market, but in limited amounts. Some of them also had access to international markets before the crisis. Seven banks are currently rated by Moody's Investors Service and five by Fitch Ratings.

[15] Since 2008, the Central Bank of Azerbaijan can directly provide local or foreign currency loans for projects of social or economic importance.

15. Azerbaijan has made progress in de-dollarizing its economy since the mid-2000s. Setbacks in 2008–2009, when the share of foreign currency deposits increased sharply due to fears of a devaluation of the manat, the local currency, have since been reversed.[16] However, 49% of bank liabilities and 49% of customer deposits were still in foreign currency as of the end of 2011. Dollarization is less pronounced on the asset side, with 39% of assets and 35% of loans in foreign currency.[17] This mismatch poses challenges for banks.

16. Since early 2009, average nominal deposit rates have been above inflation (Figure 4). Alongside deposit insurance and disincentives to save by investing in housing, this largely explains the strong deposit growth of the past 3 years. Average nominal loan rates have remained relatively stable at around 8.5 percentage points above deposit rates since 1999.[18] The large difference between lending and deposit rates leverages bank profits. However, it also suggests that the sector lacks competition and/or faces other persistent structural issues (paras. 23 and 24).[19]

Figure 4: Interest Rates and Inflation



CPI = consumer price inflation.
Source: International Monetary Fund.

17. As an anti-crisis measure, the Central Bank of Azerbaijan cut its refinance rate by 13 percentage points between November 2008 and June 2009 to ease liquidity constraints for banks. This trend has since been reversed. The interest rate for long-term funds provided by the central bank for infrastructure finance is higher than the refinance rate, but lower than deposit rates. This makes them an attractive funding source.

18. **Soundness and stability**. Banking sector stability does not seem at risk in the short to medium term.[20] The sector coped relatively well with the “stress test” of the global financial crisis. What is more, non-hydrocarbon growth, essential for the banking sector, has been strong over the past 2 years and is expected to remain so. However, Azerbaijan’s economy and, by extension, the operational environment for banks, remain sensitive to external shocks, such as a sharp decline in hydrocarbon export prices. Furthermore, most banks are not well diversified geographically and by sector, increasing their vulnerability. There is also anecdotal evidence that some banks have lost control over branches, some of which are apparently managed like franchises, posing considerable risks for these institutions and potentially for the sector.

19. Other vulnerabilities are reflected in standard banking soundness indicators (Table 3). These include issues with sector ownership and concentration: a lower market share of the

[16] Other hydrocarbon exporters in the region, such as the Russian Federation and Kazakhstan, had to sharply devalue their currencies in 2008–2009.
[17] In 2011, the Central Bank of Azerbaijan started discouraging foreign currency loans by increasing the minimum reserve requirement for foreign liabilities to 3%. The requirement for AZN liabilities has remained at 2%.
[18] Interest rates are generally set by the individual banks. The exception is rates for government-sponsored loans.
[19] Thirty-nine percent of respondents to a recent survey indicated that they do not know which bank interest rates are more advantageous (Business Insight International Research Group. March 2012. *Survey Report on Banking Sector.* Baku). This can be seen as another indicator for lack of competition in the system. Other explanations could be lack of financial literacy or limited interest in bank loans.
[20] Moody's Investors Service upgraded the Azerbaijan banking system outlook to “stable” in August 2010.

remaining state-owned bank, a higher share of foreign investment, and more competition between institutions would almost certainly increase banking sector soundness and stability.

20. The level of nonperforming loans and provisioning varies widely across the country's banks. On average, private banks have fewer loan quality problems and higher provisioning than IBA. However, even within private banks, differences are considerable, and depend mainly on their exposure to construction projects and real estate. Even so, most banks have sufficient capital and earning capacity to absorb losses, despite the weaker profitability indicators over the past 3 years for the sector in total.[21] The system-wide capital adequacy ratio is 14%, and substantially higher for private banks.[22] By contrast, IBA has not even complied with the regulatory minimum of 12% over the past 2 years—a requirement that was "waived" by the banking sector's regulator because of IBA's special status. However, the government's recent announcement of a capital injection means IBA will soon have sounder footing.[23]

21. Exposure to foreign currency risks has declined since 2008, with lower shares of foreign currency deposits and loans in overall deposits and loans, and foreign currency assets almost at par with foreign currency liabilities. As mentioned earlier, banks' exposure to foreign debt is not high: gross foreign debt stood at a manageable $2.4 billion at the end of 2011 and net foreign debt at $850 million. These amounts compare favorably with banking sector capital and official foreign exchange reserves. However, a number of issues may need addressing over the medium to long term: IBA's dominant share of banking sector foreign debt, the high share of foreign currency loans in overall loans, and foreign currency deposits that are much larger than foreign currency loans (an increasing trend). As such, de-dollarization remains on the agenda.[24]

22. Standard liquidity indicators suggest that Azerbaijan's banking sector is still vulnerable in this area. The share of liquid assets in total assets is comparatively low and liquid assets fall short of short-term liabilities. Customer deposits also fall short of loan portfolios. But banks do not rely heavily on market funds, either domestic or foreign. The stability of their funding base relies instead mainly on depositor confidence and access to government funding. There are no immediate concerns here: bank deposits have been growing strongly recently, and the government is expected to increase its investment in non-hydrocarbon sectors through banks in the short to medium term. The situation could change in the long term, when declining hydrocarbon export revenues might force the government to streamline credit lines. Banks should prepare for this by growing their deposit base and getting access to domestic and foreign securities markets to diversify their funding base. This would not only be beneficial for the soundness of the banking system but also, more broadly, for economic development.

23. **Efficiency**. Banking sector efficiency is low, as reflected in high net interest rate margins (the difference between lending and deposit rates), a high ratio of cash outside banks to deposits and, more broadly, low intermediation ratios.[25] The higher net interest rate margins are, the more costly bank intermediation is for a society. High net interest rate margins are

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[21] Lower profitability indicators for 2011 can mainly be explained by the acknowledgement and write-off by banks of crisis incurred losses. This can be seen as a positive development.

[22] The capitalization of banks (and insurance companies) was boosted by the exemption of profits used to increase statutory capital from the profit tax in 2009–2011. But such profits were subject to 10% withholding tax.

[23] According to Moody's Investors Service, some rated private banks would also need capital injections under a stress-case scenario, but the likelihood is low (Moody's Investors Service. 2011. *Banking System Outlook – Azerbaijan.* London).

[24] De-dollarization in the banking system would also increase the room for maneuver to formulate exchange rate policy.

[25] Informal lending from family and friends can be seen as another indicator for the low efficiency of formal financial institutions.

usually associated with a lack of competition between banks, small bank size, low capitalization, and an operational environment that makes lending risky.[26]

Table 3: Banking Soundness Indicators

	2005	2007	2008	2009	2010	2011
Ownership						
Number of banks	44	46	46	46	45	44
Private domestic	37	38	36	36	35	34
Foreign (majority)	5	6	9	9	9	9
State owned	2	2	1	1	1	1
Foreign-owned banks' share in assets (%)	n.a.	n.a.	8.0	8.0	9.1	9.7
State-owned banks' share in assets (%)	55.1	42.4	42.5	43.5	34.4	33.7
Concentration (%)						
Share of assets of largest bank	50.6	38.7	42.5	43.5	34.4	33.7
Share of assets of largest five banks	65.4.	62.7	62.6	61.0	60.7	57.0
Banks with capital < $2.5 million (number)	34	6	3	4	3	2
Capital Adequacy (%)						
Capital to risk-weighted assets (>12)	20.7	19.9	19.6	17.7	16.9	14.7
Capital to total assets (not risk weighted)	17.2	16.3	14.5	15.1	14.3	13.2
Asset Quality						
Private sector credit growth	49.3	85.4	54.1	8.2	11.5	16.6
Private sector credit to GDP	9.5	15.1	15.5	19.5	18.1	17.5
Non-performing loans to total loans	6.7	3.0	3.3	3.5	4.7	6.0
Specific provisions to non-performing loans	80.1	73.5	67.2	70.4	72.3	74.6
Foreign Exchange Rate Risk (%)						
Loans in foreign exchange to total loans	64.9	46.8	49.6	41.3	35.7	33.6
Deposits in foreign exchange to total deposits*	79.5	53.9	64.5	63.1	58.0	54.7
Foreign exchange loans to foreign exchange deposits	82.5	97.4	84.5	87.5	74.6	68.2
Net foreign assets to capital	32.3	-83.6	-112.5	-64.2	-70.4	-57.4
Total foreign exchange assets to total foreign exchange liabilities	100.7	96.8	94.8	100.1	97.1	90.8
Liquidity Risk (%)						
Liquid assets to total assets	25.3	14.6	13.8	11.2	15.0	14.6
Liquid assets to short-term liabilities	83.6	58.2	84.5	71.7	78.9	66.0
Customer deposits to customer loans	100.9	75.6	57.7	52.6	64.3	70.3
Earnings and Profitability (%)						
Return on Assets	1.9	1.9	1.8	2.2	0.9	–1.1
Return on Equity	13.2	14.3	14.2	16.0	7.0	–9.3
Net interest rate margin to total assets	5.2	4.6	5.2	4.9	3.8	3.7
Interest rate spread (percentage points)	6.8	7.4	6.9	10.0	8.1	8.8

Sources: Central Bank of Azerbaijan, International Monetary Fund, Asian Development Bank staff calculations.

[26] International Monetary Fund. 2012. *Financial Intermediation Costs in Low-Income Countries* (WP/12/140). Washington, DC.

24. IBA's strong market position makes it difficult for other banks to grow and realize scale economies. The market segmentation that results from special relations between banks and specific clients, thereby reducing competition, is perhaps an even more important factor.[27] Given a difficult business climate that includes a weak rule of law, banks' operations are also risky. A more active use of credit information sharing, which is supposed to reduce risks and have a positive impact on bank efficiency, has not yet reduced net interest rate margins.[28] All this suggests that more comprehensive reforms are needed to increase sector efficiency.

25. On a positive note, Azerbaijan's banks have generally managed to keep administrative costs under control by rationalizing their operations. As a result, many of them benefit from a relatively low cost base, which is comparable with that of larger banks in other countries in the Commonwealth of Independent States. Efficiency indicators diverge widely among banks, although there are highly efficient institutions in the system.[29] However, these too benefit from the large, system-wide difference between lending and deposit rates.

26. To improve the qualifications of bank staff, the Azerbaijan Bank Training Center was established in 2000 and has since received support from multiple external funding agencies. The center operates under the Azerbaijan Banks Association.[30]

27. **Outreach**. While banking sector outreach has substantially improved in recent years, considerable work remains to be done to increase it across regions and sectors, and to introduce new services. The number of bank branches, bank accounts, ATMs, and point-of-sale terminals has continuously increased. There were 666 bank branches in the country at the end of 2011, three times more than in 2000,[31] putting the population per branch at 13,600 in 2011, well down from 41,600 in 2000. The number of ATMs and point-of-sale terminals has surged under a government program, reaching 13,220 at the end of 2011 from 2,132 in 2006.[32] Of the population, 45% now has a bank account, 78% of households use banking services in one form or another, and 53% use plastic bank cards.[33]

28. However, current accounts dominate: only 4% of the population has dedicated savings accounts. Furthermore, banking is concentrated in the capital, Baku, where most branches, 55% of ATMs, and 92% of point-of-sale terminals are located. Baku also accounts for 87% of total bank loans and 92% of household deposits. Regions outside of the capital appear underserved.[34] Banks also narrowly focus on a relatively small number of economic activities

[27] This applies in particular to corporate banking and project finance. In retail and SME banking, competition has increased.

[28] Before the crisis, insufficient use was made of credit information sharing because the central credit registry at the Central Bank of Azerbaijan was not sufficiently user-friendly. Since then, the registry has been improved substantially with World Bank support. It now has information on repayment histories, unpaid debts, and outstanding credit of almost 1.2 million borrowers. It covers 15.6% of the adult population and firms, up from 3.1% in 2007. The registry responds to around 45,000 inquiries per month, mostly by banks. It was opened to nonbank financial institutions in 2010. Credit information sharing is not yet a regulatory requirement due to concerns about bank privacy.

[29] IBA, unlike many state-owned banks in other countries, has historically been reasonably cost-efficient, given its focus on corporate banking, strong deposit base, and economies of scale. IBA's cost efficiency has also benefited from the closure of many branches since 2008.

[30] The Azerbaijan Banks Association was established in 1990. All banks and four nonbank credit institutions are members.

[31] Private banks account for this dynamic. IBA's branch number fell from 125 before October 2007 to 37 in 2011. However, some private banks seem to have lost control over some branches, which are managed like franchises.

[32] A 2005 presidential decree required point-of-sale terminals in all shops and restaurants. However, many shops and restaurants still do not have these terminals or, if they do, avoid running card transactions to minimize taxation.

[33] Business Insight International Research Group. 2012. *Survey Report on Banking Sector—March 2012*. Baku.

[34] Financial sector concentration in Baku, to some extent, reflects the concentration of Azerbaijan's economic activity on the Absheron peninsula, which includes the Baku and Sumqyavit region. Absheron is not only the center of the

and sectors: loans to households, services, and agriculture account for 70% of bank loans. Information about the number of transactions per ATM and point-of-sale terminal and transaction volumes suggest that their introduction has not been an unqualified success. The average usage of a point-of-sale terminal is just 16 times per month. Overall transaction volumes for ATMs and point-of-sale terminals have been stagnant over the past 2 years.

29. Financial statistics do not provide a gender breakdown. However, survey results suggest that while men are more likely to use financial services (60%), women are somewhat more likely to use loans (53%). However, 41% of the loans taken by women are consumer loans in contrast to 37% for men. Consistent with this, men dominate longer-term borrowing.[35]

30. **Regulation and supervision**. No systematic assessment of banking regulation and supervision in Azerbaijan compared to international standards and good practice has been disclosed since 2003.[36] However, at the request of Azerbaijan's authorities, an assessment is scheduled under the Financial Sector Assessment Program of the International Monetary Fund and World Bank for 2014.

31. There is already consensus among industry specialists that while banking legislation and regulation have significantly improved in recent years, weaknesses remain, and particularly in the area of corporate governance of banks, single-borrower concentration, related-party lending, loan classification, consolidated supervision, and cross-border banking supervision. Weak capacity and the strong political connections of many banks might make it difficult for the Central Bank of Azerbaijan to implement and further strengthen the legal and regulatory framework for banking in line with international good practice. The central bank, which is formally independent from the government, still plays an important role in implementing government-sponsored development programs. This suggests that the central bank might prioritize development objectives over sector soundness in cases of conflict.[37] Furthermore, regulatory actions appear to be not as transparent as desirable to safeguard regulatory independence.

32. On the issue of disclosure, all banks are required to submit their financial statements in line with International Financial Reporting Standards. Banks are also required to have their financial statements audited by a qualified external audit company. In recent years, most leading banks have undergone audits from the big-four international audit firms, while smaller banks have preferred to work with other (top-ten) international audit firms.[38]

33. Progress has also been made in anti–money laundering. In February 2009, a new anti–money laundering law was passed to provide a sound legal basis for anti–money laundering and terrorist financing. The Financial Monitoring Service, a financial intelligence unit established under the central bank in 2009, receives and analyzes reports on money laundering.

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oil and gas industries, but also of other heavy industries (chemistry and metallurgy) and of the light and food industries. However, Absheron accounts for only 29% of Azerbaijan's total population.

[35] Business Insight International Research Group. 2012. *Survey Report on Banking Sector—March 2012*. Baku.

[36] The Central Bank of Azerbaijan conducted self-assessments in 2004, 2008, and 2010, but they were not publicly released. The assessments, therefore, could not influence depositor and investor confidence, even if the central bank did use them to guide reforms.

[37] This view seems consistent with the fact that banks are allowed to sustain high levels of single-borrower exposure to finance large investment projects, and that IBA could be in breach of capital adequacy requirements for more than 2 years without facing restrictions to its operations.

[38] Many larger non-financial companies also voluntarily submit their financial statements in line with International Financial Reporting Standards. A key incentive is to get financial support from external funding agencies such as the European Bank for Reconstruction and Development (EBRD), the International Finance Corporation (IFC), or Kreditanstalt für Wiederaufbau, which generally require reporting in line with international standards.

B. Microfinance

34. Azerbaijan has a number of professional providers of microfinance. However, the sector is surprisingly underdeveloped, as reflected in low intermediation volumes. At the end of 2011, Azerbaijan had 27 microfinance organizations[39] and 97 credit unions. An increasing number of banks also provide micro-loans.[40] The 31 leading providers of micro-loans, including 16 microfinance organizations, 13 banks, and 2 credit unions, are members of the Azerbaijan Microfinance Association (AMFA).[41] At the end of 2011, AMFA members had an outstanding microfinance credit portfolio of $0.7 billion equivalent (1% of GDP) and almost 390,000 active borrowers, up from 100,000 in 2006. Thirty-five percent of borrowers were women.

35. The product range of AMFA members includes micro-credit; consumer, automobile, household, and seasonal loans; and, in some cases, SME loans. However, consumer lending accounts for only 14% of the loan portfolio and SME lending is rare. The average loan size of AMFA members is $1,800; microfinance organization loans are usually smaller than that, while bank loans are larger. Individual loans dominate microfinance, but some institutions make intensive use of group lending. Loan interest rates range widely between 20% and 50% per year. Sector concentration is high, with the two largest providers of microfinance, Accessbank and FINCA (Azerbaijan), together accounting for 46% of the micro-credit portfolio of AMFA members (Table 4). Both organizations have extensive reach outside the capital.[42] Accessbank, which is largely owned by external funding agencies, received strong financial support during the global financial crisis, allowing it to substantially increase its market share. Most other AMFA members and microfinance providers outside AMFA are small or very small.

36. Microfinance credit growth has been strong over recent years, with the loan portfolio of AMFA members alone increasing by 36% in 2011. This has raised sustainability concerns. AMFA itself is concerned about multiple borrowing by customers and the related risks of over-indebtedness, and has launched research in this area. An aggravating factor is weak sector supervision, particularly regarding nonbank credit institutions. However, progress in credit information sharing should mitigate the risks to some extent. Lending levels are also still small from a macroeconomic perspective, which means that widespread over-indebtedness of households and micro-borrowers appears unlikely for now. At any rate, external funding agencies, which are still the key driving force behind microfinance in Azerbaijan, should take sector developments into account when undertaking due diligence for loans. This includes international finance institutions supporting the downscaling of banks.

37. **Microfinance organizations**. The first microfinance organizations in Azerbaijan were established in the mid-1990s by organizations like FINCA, Oxfam, and World Vision to meet the financial needs of the poor, and particularly people displaced by the Nargorny-Karabakh inter-ethnic armed conflict. This is why microfinance organizations were given tax benefits and other privileges. However, the authorities granted these privileges only to organizations that were supported by foreign humanitarian organizations and did not allow other microfinance organizations to operate. As a result, the total number of microfinance organizations increased slowly from 14 in 2004 to 18 in 2007–2010. The policy and regulatory regime for microfinance organizations became increasingly obsolete, given that most microfinance organizations commercialized, and support from international humanitarian organizations was increasingly

[39] Microfinance organizations are licensed as nonbank credit institutions in Azerbaijan.

[40] Accessbank was established as a microfinance bank in 2002. The downscaling efforts of other banks are supported by various donor organizations, including EBRD and IFC.

[41] AMFA, established in 2001, has three strategic pillars: innovative products and services, continuing education for borrowers and practitioners, and becoming a source for microfinance expertise. Since 2010, AMFA has been implementing a gender mainstreaming project, supported by Microfinance Network, a grassroots network of microfinance institutions from Europe and Central Asia, and Oxfam.

[42] Seventy percent of FINCA's clients are outside Baku.

replaced by international wholesale funding. This regime made it difficult for microfinance organizations to change their ownership structure, which constrained equity investment and, in turn, the development of the microfinance sector.

Table 4: Leading Providers of Microfinance[a] in Azerbaijan (March 2012)

Name	Microfinance portfolio ($ million)[a]	% assets	Other Information
Accessbank	189.073	38.7	Fully donor-owned microfinance bank
FINCA (microfinance organization)	118.471	87.6	Associated with FINCA International
Vision Fund (microfinance organization)	44.865	84.5	Owned by World Vision International
NBC Bank	35.368	40.3	
Krediagro (microfinance organization)	32.895	86.3	Established in 2000 under USAID project. Since 2008 fully owned by ACDI/VOCA
Technika Bank	28.044	3.8	
Bank of Baku	25.976	6.1	
Demir Bank	25.774	5.5	
Parabank	23.207	16.7	
Turanbank	21.511	9.4	
Unibank	17.444	3.0	
Agrarcredit (microfinance organization)	15.550	47.3	State owned
Finance for Development Fund (microfinance organization)	13.047	92.8	Owned by Oxfam United Kingdom
Viator Microcredit (microfinance organization)	11.276	90.6	Founded by Humanitarian Enterprise in 1999 to support SMEs
Nakhchivan Credit (microfin. org.)	10.582	100.7	

SMEs = small and medium-sized enterprises

[a] Loan size $100–20,000.

Sources: Ministry of Finance, expert interviews, media reports.

38. All these factors led to a change in the legal and regulatory regime, culminating in the enactment in February 2010 of the *Law on Nonbank Credit Institutions* (which does not apply to credit unions), the transfer of regulatory responsibility for nonbank lenders from the Cabinet of Minister's Department for Problems of Refugees to the Central Bank of Azerbaijan, and the introduction of prudential regulation.[43] Microfinance organizations lost most of their privileges. Given that this involved, among other things, retroactive payments of social contributions, the process was painful for most microfinance organizations and slowed sector growth. Under the new framework, nine additional microfinance organizations entered the market in 2011 (as nonbank credit organizations), bringing the total to 27. Most of the new entrants are domestic investors, mainly former bankers who regard microfinance as a profitable business.

39. The microfinance organization branch network increased more steadily compared with the total number of organizations. Branches increased from 13 in 2005 to 74 in 2011, as existing microfinance organizations expanded into all the country's provinces and most of its districts.

40. Over that period, microfinance organization assets grew from 0.3% to 0.5% of GDP. This is still small from an international perspective. The global financial crisis slowed asset growth by reducing the availability of wholesale funding, particularly in 2009–2010. However, in 2011, asset growth accelerated again, to 30%, back to precrisis levels. For AMFA members, portfolios

[43] The Central Bank of Azerbaijan is still building capacity to implement the new regime. On-site inspections, for instance, have apparently not yet been fielded, even in large microfinance organizations. Weak capacity for regulation and supervision of microfinance organizations (and credit unions) is at least partly because the Central Bank of Azerbaijan prioritizes the supervision of banks over the supervision of nonbank financial institutions. This is not untypical for regulatory bodies overseeing a dominant subsector such as banking, and other much less developed subsectors.

at risk never rose above 3.3% of total microfinance lending, despite the crisis-induced economic slowdown.[44]

41. In the coming years, the number of microfinance organizations will likely increase. Some of the larger microfinance organizations, such as FINCA, are interested in transforming into banks to offer their customers a broader range of services.[45] However, the Central Bank of Azerbaijan does not see such a transition as a priority, because it wants to reduce the number of banks. What is more, an increasing number of licensed banks already provide microfinance services. Microfinance organizations and banks aim to increase their reach in rural areas, where AMFA estimates there are more than 300,000 small and micro businesses which have no access to financial services. Increasing competition between microfinance organizations in rural areas should help reduce interest rates. It might also help introduce new services such as micro-insurance and micro-leasing.

42. **Credit unions**. These were established in Azerbaijan from 1997, mainly to access external funding,[46] which is perhaps the key reason why total assets of credit unions have never exceeded 0.1% of GDP. The World Bank alone has made $18 million equivalent available to credit unions through the country's ministries of finance and agriculture, and an implementing agency, which is now owned by the association of credit unions.[47] The number of credit unions increased to 77 by 2006, and stagnated thereafter because access to the credit line was restricted to already existing credit unions. After this policy was changed in 2010, the number of credit unions increased to 97 in 2011. A revival of interest in credit unions was apparently also partly due to more difficult access to bank credit in rural areas during the global financial crisis. As this stage, credit unions have about 12,000 active borrowers and a loan portfolio of $29 million equivalent. The average loan size is $1,960.

43. Given that the World Bank funds were fully absorbed by 2011 and repayment of the first installments started in 2010, credit unions face potential funding problems. The government has tried to mitigate this by injecting development funds into the sector. Individual credit unions have apparently also gained access to wholesale funding like microfinance organizations. This suggests that credit unions in general have not been making much progress in mobilizing funds from their own members, and that many credit unions are still controlled by a few individuals. Similarly, the implementing agency of the World Bank project has not yet transformed into an apex organization that provides credit unions with treasury, payment, and other services.

44. The government introduced legislation on credit unions relatively late, in 2000, followed by prudential regulations in 2001. Since many credit unions had already been in existence by then, enforcement was an issue. However, the fact that 29 credit unions lost their licenses between 2005 and 2011, while 71 were newly licensed, suggests that sector regulation is now on a sounder footing. The supervisory authority, the Central Bank of Azerbaijan, has not been

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[44] The indicator, which covers payments overdue for more than 30 days, was worse for banks than for nonbank credit institutions.

[45] A banking license would also allow microfinance organizations to complement their funding base through deposits. However, given that deposit rates are higher than available wholesale funding, microfinance organizations in general are not much interested in deposit taking.

[46] The three principal drivers were the European Union's Technical Assistance to the Commonwealth of Independent States programs to support agricultural finance, the Social Fund for Development of Internally Displaced Persons, and the World Bank's Agricultural Development Credit Project.

[47] The World Bank loan has a maturity of 35 years and a grace period of 10 years. Credit unions can borrow from the implementing agency up to three times the amount of their statutory capital. Borrowing from other sources is not included in the ratio, however, so credit unions in Azerbaijan can have a very high exposure to debt. After loan repayment, a revolving fund at the Ministry of Agriculture recycles loan resources back to credit unions through the implementing agency. The agency currently pays 10.25% per year for its credits from the government and onlends to credit unions for 25%. Credit unions can borrow for up to 1 year. For funds provided by the Social Fund for Development of Internally Displaced Persons the maturity period is up to 3 years.

receptive to requests that credit unions be allowed to raise deposits. This is in part because credit unions had a track record of incurring losses before the government tightened regulations. As a result, theytstill rely on external funding and to a lesser degree on member shares.

C. Insurance

45. Insurance is still nascent in Azerbaijan, although the government has started to support its development by strengthening the enabling environment and introducing mandatory insurance. The sector comprises 29 insurance companies, 1 reinsurer, 7 brokers, about 200 agents, and the Association of Azerbaijani Insurers. The number of insurance companies declined from 71 in 1995 to 29 in 2003, and has remained relatively stable since then. Many insurance companies are linked with banks. The sector does not seem to be overly concentrated. The largest institution, which is state-owned, has a share of 12.3% of total premiums (Table 5). The largest five institutions have a combined market share of 46.9%. However, most insurance companies focus on specific products, such as medical, motor, or life insurance. Sector segmentation is therefore high and competition limited.

46. The market share of foreign institutions is low at around 7% of premiums. Only two foreign insurance companies have so far entered the market. The first was American International Group (AIG, now Chartis), which established a joint venture AIG Azerbaijan in the 1990s and took full control of the company in 2009. This was enabled by the removal of a 49% foreign ownership limit on Azerbaijan insurance companies in terms of share capital.[48] The second was French AXA Group, which bought 51% of Azerbaijan insurer MBASK from its principal shareholder and the European Bank for Reconstruction and Development (EBRD); EBRD had held a minority shareholding in MBASK since 2004. The market shares of AXA MBASK and Chartis are 6.0% and 0.8%, respectively. Only AXA MBASK offers retail insurance.

Table 5: Leading Insurance Companies in Azerbaijan, 2011
(AZN million)

	Name	Premiums*	Claims*	Other Information
1	State Insurance Company	26.145	11.078	State owned.
2	Ipek Yolu Insurance	21.581	8.976	
3	Az Insurance	20.788	1.978	
4	Ateshgah Insurance	18.547	6.204	
5	AXA MBASK	12.725	3.244	51% foreign owned. Main domestic shareholder linked to Unibank. Mainly health insurance.
6	Beynalxalq Insurance	12.409	5.687	Linked to International Bank of Azerbaijan.
7	PASHA Insurance	10.508	2.192	Part of Pasha Holding. Mainly health insurance.
8	Standard Insurance	9.723	2.788	Linked to Standard Bank through Standard Group.
9	Ateshgah-Hayat (Life)	9.524	0.170	Life insurance only.
10	Xalq Insurance	8.752	2.594	Linked with Halq bank.
11	PASHA Life Insurance	8.185	0.181	Pasha holding. Life insurance only.
12	A-Qroup Insurance	8.106	5.340	
13	Qarant Insurance	8.092	1.251	Linked to Bank of Azerbaijan through ZQAN Holding.
14	Azerbaijan Senaye Insurance	6.694	1.802	
15	Ata Insurance	5.441	2.086	Linked to Ata Bank through Ata Holding.
	[…]			
23	Chartis	1.604	0.015	Fully foreign owned. No retail products.
	Sector total	**212.982**	**61.567**	

Sources: Ministry of Finance, expert interviews, media reports.

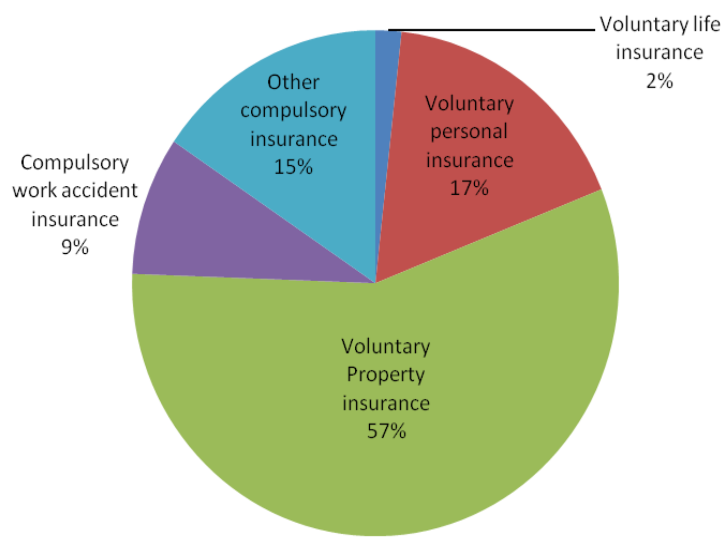
[48] Other restrictions are still in place: foreign individuals and local subsidiaries of foreign corporations are prohibited from acquiring shareholdings in local insurance companies. Only qualified foreign insurance companies can. Furthermore, foreign insurance companies are prohibited from establishing branches in Azerbaijan.

47. Foreign companies play a larger role in reinsurance. While the share of premiums that is reinsured has fallen from 51% in 2008 to below 40% in 2010–2011, foreign companies, mainly from the United Kingdom, Turkey, and the Russian Federation, have a market share of more than 50%. The domestic reinsurer accounts for about 40% of the market.

48. Since 2008, the government has undertaken noteworthy efforts to develop the insurance sector, starting with the adoption of a new insurance sector law in March 2008, which replaces a 1999 law.[49] The insurance sector regulator, the State Insurance Supervision Agency under the Ministry of Finance, has since strengthened regulation and supervision.[50] Progress has also apparently been made in enforcing insurance sector regulations, as evidenced by the revocation of licenses of institutions that do not meet requirements. Still, the insurance regulator acknowledges that there is scope for strengthening sector regulation and capacity for supervision.[51] .

49. So far, the insurance sector remains small, with total assets at 0.8% of GDP and premiums at 0.4% of GDP in 2011. Premiums decreased somewhat in 2009 and 2010 when declining car loans affected motor insurance, lower trade turnover affected cargo insurance, and the delay of big construction projects affected property insurance. In contrast, strong premium growth of 69% in 2011 was mainly due to the economic recovery and the introduction of compulsory liability insurance against accidents at work in late 2010.[52] Nevertheless, until 2011, voluntary property insurance was the dominant insurance product (Figure 5). For 2012, robust insurance sector growth is expected, following the introduction of compulsory property insurance in late 2011.

Figure 5: Structure of Insurance Premiums, 2011



Source: Ministry of Finance, Azerbaijan

50. Insurance sector capitalization has strongly increased over recent years, mainly as a result of tax breaks for recapitalized profits and an increase, in 2008, in minimum capital requirements from AZN1 million to AZN5 million for insurers, and from AZN2 million to AZN10 million for reinsurers. Higher capital cushions have reduced reinsurance needs. On the asset side, insurance companies still put most of their funds in bank deposit accounts. This is partly due to links between the insurance companies and banks, but also to the underdevelopment of the domestic securities markets and lack of access to foreign markets.

[49] The new law was drafted with technical support under the multi-donor initiative First.

[50] As earlier mentioned, no assessment of financial sector regulation and supervision against international best practice has been disclosed in recent years.

[51] At this stage, eight staff members are in charge of insurance sector supervision.

[52] Voluntary life insurance operates almost wholly on the basis of forgiveness of tax and social contributions. There are few other investment returns for the insured. This means that the tax and social security system is being used to shift benefits to better-paid employees.

D. Securities Markets

51. **Institutional arrangements**. Securities markets are still small in Azerbaijan, but increasingly contribute to capital mobilization. The basic market infrastructure has been in place for more than a decade, although it was initially designed to support the privatization of state-owned enterprises. The State Committee for Securities (SCS) under the president of Azerbaijan is the regulatory body. Trading takes place at the Baku Stock Exchange (BSE) and over the counter (OTC). There are 13 broker-dealers, 2 registrars, and 3 depositories. The National Depository Center, which mainly serves the BSE, partly integrated its systems with the BSE in 2009.

52. The BSE was established in 2000 by local banks and investment companies and the Istanbul Stock Exchange.[53] At the end of 2011, it had 16 members. The BSE organizes trades in company shares (equity), corporate bonds, treasury bills and bonds, and Central Bank of Azerbaijan notes; no derivatives are traded. It also engages in clearing, information services, and consulting, and has a tailor-made online trading system with remote access and 30 workstations for brokers at its floor.[54]

53. The pool of enterprises that could issue securities in Azerbaijan is not small. Out of a total of more than 80,000 enterprises, about 1,200 are joint stock companies with more than 20 shareholders. About 250 of them have more than 100 shareholders. Many larger companies are still state owned and have alternative sources of funding. The government has also not yet started to list state-owned enterprises and there are few incentives for private companies to list; only one company is now listed on the BSE.[55] However, issuance and trading of securities is not restricted to listed companies.

54. **Equity markets**. In 2000–2003, most primary issues of shares (equity) were privatization related, but that has since changed. In 2007, the year before the global financial crisis, 135 share issues were newly registered, equivalent to about $920 million or 2.9% of GDP. Additional rights issues to existing shareholders presumably accounted for the majority, but shares were also issued to mobilize additional capital from new shareholders. Equity markets have therefore contributed to capital mobilization. Share issues declined dramatically during the crisis, but 2010–2011 saw a revival. Shares totaling $1.2 billion equivalent (2.0% of GDP) were issued through 142 issues in 2011, with banks accounting for 14%, insurance and leasing companies accounting for 1%, and non-financial companies for the balance. According to SCS, all share issues in 2011 were issued to attract external capital. BSE dominates the primary market for equity with a share of 99% in issuance volume. Nearly 100% of issues were paperless (i.e., electronic).

55. The BSE claims that shares of about 700 enterprises are traded on its secondary market, but most of them only occasionally. With total turnover of $60 million equivalent and 4,580 transactions in 2011—18 on average per trading day—the secondary market is still very small. The BSE now accounts for 75% of all transactions, in contrast to OTC dominations before the crisis. However, it cannot be entirely ruled out that many transactions are still arranged outside the exchange between the buyer and the seller, and only executed through the exchange. Such “direct deals” would not provide timely pre- or post-trade price transparency. In any case, there is considerable room for strengthening secondary market liquidity and transparency.

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[53] The BSE has been a member of the Federation of Eurasian Stock Exchanges since 2001.

[54] The BSE trades 5 days per week. Clearing and settlement is still on a gross basis and conducted manually. The settlement circle is T+0. There is no international custodian.

[55] The number of listed companies declined from 47 in 2004 to 9 in 2008, and has since fallen further due to stricter listing requirements. Companies see no financial benefit in listing. And there is no regulatory requirement to list, not even for companies that are “public” in nature. Legislation does not define a “public company.”

56. **Bond markets**. The number of corporate bond issues increased from 20 in 2007 to 101 in 2011, for total capital raised of more than $740 million equivalent (1.2% of GDP) in 2011, up from $90 million equivalent (0.3% of GDP) in 2007. While this is a substantial amount, 65% of the capital raised was for a single OTC bond issue in US dollars. The remaining issues were predominantly in local currency and through the BSE.

57. Bonds are issued with maturities of up to 10 years. The most active bond issuer is the state-owned Azerbaijan Mortgage Fund (AMF), which accounted for 93% of primary bond issues in 2009. AMF bonds in circulation have a maturity of 7 or 10 years and a yield of 3% (for covered bonds). When the market for corporate bonds revived in 2010 and 2011, AMF's primary market share fell to 82% and 39%, respectively.

58. Banks accounted for 17% of corporate bond issuance in 2011. This included Unibank, which issued several bonds in 2011 and early 2012.[56] Leasing companies accounted for another 6% of issuance in 2011. The remaining 38% of corporate bonds were issued by nonfinancial enterprises. It is important to note that there were no bond defaults in Azerbaijan during the global financial crisis.

59. Secondary corporate bond market turnover amounted to almost $0.7 billion equivalent in 2011, or about 10 times higher than equity market turnover. However, the total number of transactions was much smaller, at 120. The secondary market for corporate bonds is therefore very illiquid. Most transactions take place at the BSE rather than on an OTC basis, which is unusual from an international perspective.

60. The issuance of treasury bills increased over the crisis period to peak at 2.1% of GDP in 2009, before declining to the precrisis level of 0.5% of GDP by 2011. The longest available maturity period is 3 years, but most bills have shorter maturities. Bills in circulation only amounted to 0.3% of GDP at the end of 2011. Short-term Central Bank of Azerbaijan notes in circulation added another 0.2% of GDP. Most treasury bills and central bank notes are held until maturity, so secondary market trading volumes are very small. However, treasury bills and central bank notes are actively used as collateral for money market transactions (repo deals).

61. **Regulation and supervision**. Azerbaijan has not had a distinct securities market law since the 1992 law On Securities Markets and Stock Exchanges was replaced by provisions in the Civil Code. These provisions are complemented by a number of by-laws, such as the 1999 Resolution on the SCS and the 2000 Resolution on the BSE. The legal and regulatory framework for securities markets in Azerbaijan was benchmarked against International Organization of Securities Commissions principles in 2003. The country achieved "very low compliance." All areas assessed were in critical need of reform.[57] While many of the issues identified then might still be relevant, a major initiative has been under way since 2009 to address them. The SCS has already been given the right to adopt normative acts to regulate the

[56] Some companies also have access to international markets. In February 2012, State Oil Company of Azerbaijan raised $4.6 billion for 5 years at a yield of 5.45% through its debut Eurobond issue. Other state-owned enterprises and perhaps rated banks are expected to follow.

[57] The assessment flagged pronounced weaknesses in the area of disclosure requirements. Prudential requirements for market intermediaries and surveillance of secondary markets were found to be very weak. Minimum standards for self-regulatory organizations had yet to be established. The SCS was found to lack operational and functional independence. Accountability arrangements were also assessed as inadequate. The SCS was under presidential authority and, hence, formally independent of the government. However, it was financed through the state budget and the government had to approve SCS's draft budget. SCS staff were also not protected against lawsuits for actions taken in their official function. Moreover, the SCS lacked the power to directly survey market participants and investigate. It had the right to issue administrative sanctions, which were, however, inadequate to discourage illegal behavior. No arrangements were in place for cooperation with the banking regulator and regulators in foreign jurisdictions.

securities markets and its participants, license market activities, protect investors and market participants, and promote fair market practices. The BSE has also introduced new listing rules incorporating corporate governance requirements. A new securities market law, which would give the SCS a sound legal basis for market regulation, has been drafted, but not yet enacted.

E. Other Financial Service Providers

62. **Azerbaijan Mortgage Fund**. The AMF was established as a public sector entity by presidential decree in 2005 to "provide a mechanism for housing finance through long-term mortgage loans, as well as to facilitate attraction of local and foreign financial resources." The AMF reports directly to the central bank, whose management board acts as AMF's board of directors.[58] The AMF had just one branch and less than 60 staff members.

63. AMF assets grew from a negligible amount in 2006 to about 0.7% of GDP by the end of 2011. The AMF's loan portfolio accounts for about 75% of its assets. Although it has its own separate budget, it still receives budget income appropriations. In recent years, issuing domestic bonds has become the AMF's main funding source, and it is the country's largest bond issuer. Investors are mainly domestic banks and insurance companies. With AMF bond yields at 3% a year—which is significantly below annual inflation and bank deposit rates—there might be an element of captured investment.

64. AMF mainly refinances commercial bank mortgage loans, which need to be prequalified by the Central Bank of Azerbaijan; 24 banks are currently prequalified. In 2011, AMF refinanced 81% of the mortgage loans; the remainder was financed by credit lines from external funding agencies. AMF-funded mortgage loans have a maturity of up to 25 years, an interest rate of 8% per year, and a maximum amount of AZN50,000 ($62,500).[59] Young families and members of the military can get mortgage loans of AZN35,000 ($43,750) maximum for up to 30 years at 4%. Commercial banks participating in the AMF's mortgage programs cannot vary the uniform set of terms and conditions. Before AMF refinances mortgage loans, mortgage objects have to be appraised by appraisal companies and insured by insurance companies, both of which are selected by AMF.

65. **Azerpost.** When Azerpost was corporatized in 2010, it received a license from the Central Bank of Azerbaijan to provide payment transfer services and open customer accounts. Azerpost still cannot take deposits or lend, but this might change. With its 63 branches and 867 satellite offices, Azerpost has an extensive reach. It is a major player in utility payment collection.

66. **Baku Interbank Currency Exchange.** The exchange, which became operational in 1994, is the main trading platform for foreign currency. It has an electronic trading system, which processed trades totaling AZN994 million in 2011. This seems quite small, even if Azerbaijan's fixed exchange rate regime rules out trading for speculative purposes. However, there is also off-exchange trading.

67. **National Fund for Support to Entrepreneurship**. The fund, established in 2002 by presidential decree, provides loans to entrepreneurs. Commercial banks participate in credit appraisal, disbursement, and payment collection, but the loans remain on the fund's balance sheet. At the end of 2011, the fund had assets equivalent to $570 million (1% of GDP) and loans equivalent to $560 million, which is comparable to that of a medium-sized bank. The fund

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[58] The AMF's ratings are equalized with the Azerbaijan sovereign rating, reflecting the entity's public sector status, its tight control by the government through the central bank, and its important role in the government's housing finance policy.

[59] The AMF's funding costs are 3%, AMF's margin 1%, and the margin of the commercial banks involved 4%.

has hardly any capital. Its funding sources are limited to annual assignments from the state budget and revolving credits. Total assets and loans have been growing at an annual rate of 9.5% in 2010 and 2011. At 6%, the official loan interest rate is highly concessional. According to market participants, effective rates are substantially higher due to rent-seeking practices in the fund and the banks involved. But even if this is the case, loans still seem to be attractive, particularly given their long maturity period of 3–10 years depending on loan size. The fund provides loans from AZN5,000 ($6,400) to AZN10 million (12.3 million). So far, it has supported about 12,500 enterprises, which suggest an average loan size of $47,000. Agricultural production and processing accounted for 76% of loans disbursed in 2011. Industry (excluding the processing of agricultural goods) accounted for another 15%.

68. **Private equity**. While the concept is still very new in Azerbaijan, some investors are considering the establishment of private equity funds. A case in point is Pasha Holding, which is preparing a fund of $10 million.

69. **Pension funds.** There are currently no private pension funds in Azerbaijan. A draft private pension law was withdrawn a few years ago amid concerns that domestic securities markets were not yet developed enough to absorb pension fund investments.

IV. GOVERNMENT SECTOR STRATEGY

70. The State Program on Poverty Reduction and Sustainable Development of the Republic of Azerbaijan for 2008–2015 (Poverty Reduction Program) identifies the banking, insurance, and securities markets as priority areas for financial market development. Financial sector reforms in recent years have closely followed the objectives outlined in the Poverty Reduction Program, despite the distraction of the global crisis and its impact.

71. For banking, as announced by the Poverty Reduction Program, capital requirements for banks have been increased, Basel II capital adequacy standards introduced, and deposit insurance established. The outreach of banks and nonbank credit institutions, which are also covered under banking, has been expanded into underserved areas, a postal deposit system created, and a system of mortgage crediting established. The program also includes a commitment to support private banks, whose market share has indeed substantially grown in recent years. The objective to attract more foreign investment has been less successful, at least in equity investment, but this might change through the privatization of IBA.

72. Building on the Poverty Reduction Program, the Central Bank of Azerbaijan developed Strategy 2011–2014 for further reforms in the banking sector and other areas under central bank jurisdiction. The strategy includes a commitment to strengthen banking legislation and regulation in line with the latest changes to international standards and best practices. It includes two strategic objectives that directly relate to financial sector development: (i) to create a framework for risk-based supervision by developing a new architecture for sector supervision and formulating implementation procedures; and (ii) to design a modern cash management system, which will include the establishment of a fully automated cash center.

73. A separate strategy for nonbank credit institutions, which are also under the central bank's jurisdiction, is not available. However, the microfinance sector association, AMFA, makes an important contribution to sector development in line with international good practices.

74. For the securities market, the Poverty Reduction Program establishes objectives, such as strengthening the legal framework, protecting investor rights, improving settlement of transactions, establishing a national depositary center, encouraging self-regulatory bodies, strengthening market surveillance, and using securities to mobilize resources for mortgage

loans. While some of these steps have already been taken, it is the much more detailed State Program for Development of the Securities Market for 2011–2020, approved by presidential decree in May 2011, which is now guiding reforms. This program includes a comprehensive, specific, and time-bound reform agenda. The program covers (i) the improvement of capital market infrastructure and trading architecture, (ii) stimulating supply to enhance the range of capital market instruments and services, (iii) encouraging demand through corporate education and public awareness outreach, and (iv) strengthening the legal and regulatory framework, as well as improving the capacity of the regulatory body.

75. In insurance, the Poverty Reduction Program 2008–2015 envisages an improvement in the legal framework, encouraging the development of reinsurance, establishing insurance associations, improved control over insurance activities, and a single register on foreign reinsurers and insurance brokers. Actual reforms have moved along these lines with the enactment of a new insurance law and the establishment of associations. In addition, minimum capital requirements for insurance companies have been increased and various types of mandatory insurance established to create a mass market for insurance products.

V. POTENTIAL AREAS FOR ASSISTANCE

76. **Strategic focus.** External funding agencies have already provided substantial assistance for financial sector development in Azerbaijan (Appendix). However, in view of low intermediation levels across all segments of the financial sector and its negative impact on overall economic and social development, additional support can be justified. Even the banking sector still needs additional assistance.

77. The focus of financial assistance might, nevertheless, have to gradually shift to nonbank financial institutions and services. Banks are already relatively successful in mobilizing domestic deposits, although more needs to be done. The banking sector also benefits from substantial inflows of government funds. Finally, more and more banks are able to attract (debt) capital from private banks and investors abroad. In contrast, the need of nonbank financial institutions for direct financial assistance seems as urgent as the need of banks a decade ago.

78. **Regulation and supervision.** The government remains committed to bringing the policy, legal, regulatory, and institutional frameworks for the financial sector fully in line with international standards and good practices. Work under the Financial Sector Assessment Program, scheduled to resume in 2014, will allow discussion and operationalization of the objectives. This is particularly needed in banking, microfinance, and insurance. After the financial sector assessment, the government will likely need support from the broader donor community to achieve its objectives. For securities markets, an elaborated reform initiative is already under way.

79. In banking regulation and supervision, it is already clear that technical assistance is needed in the areas of single-borrower exposure, related-party lending, loan classification, consolidated supervision (of groups of financial institutions), and cross-border banking. It will be more difficult, but may be even more important, to strengthen and better implement the regulatory framework for corporate governance in banks. Further strengthening the legal, financial, and operational independence of the Central Bank of Azerbaijan will be crucial in this context to improve its enforcement capability. Special attention should also be given to accountability arrangements, as well as the transparency and integrity of central bank activities.[60] Stronger banking regulation and supervision will create a more level playing field,

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[60] Independence and accountability are two sides of the same coin. Independence cannot be effective without proper accountability. Transparency is key to making accountability work. It is also a vehicle for safeguarding independence.

which will invigorate competition and help the better banks more effectively mobilize resources through deposit taking and the issuance of securities in domestic and international markets.

80. The Central Bank of Azerbaijan might also benefit from knowledge transfer in the area of de-dollarization, which would be useful for financial institutions, enterprises, and households alike. A transfer of knowledge in the area of electronic payments might also be merited, given the mixed results of reforms in recent years. The infrastructure for electronic payments has improved, but the overall business environment is not supportive at this stage.

81. **Bank privatization and state resource intermediation.** Donor support might also be appreciated to prepare the ground for IBA privatization. The establishment of a dedicated development bank, if planned by the government to free commercial banks from policy lending functions, could be an area where the government would benefit from international knowledge transfer. The government should, of course, try to channel resources earmarked for non-hydrocarbon sector development as much as possible through private sector commercial banks into the economy. The rationale is to use banks' capacity in financial analysis and implementation of projects. Assistance might be needed for the government to choose the most efficient instruments for this type of intermediation, including making government deposits available to banks through tenders, investing in securities issued by banks, establishing cofinancing and guarantee schemes, and so on.[61] Direct Central Bank of Azerbaijan credits to enterprises and the way the National Fund for Support to Entrepreneurship provides assistance are not the most efficient way to channel government resources into the economy from the point of view of international good practice.

82. **Assistance to individual banks.** There is still room for traditional trade finance and SME credit lines from external funding agencies, despite the improving access of Azerbaijan's banks to international market funding. However, donors might want to consider making more use of guarantees to leverage banks' access to foreign credit lines, syndicated loans, and capital markets. Direct financial assistance should perhaps increasingly be provided in the form of equity or quasi-equity, since capital is what many banks in Azerbaijan need most. Support in whichever form should focus on banks that make credible efforts to attract deposits. Developing the domestic deposit base is crucial for sustainable banking sector development, particularly since government support for the sector might decline after oil exports peak around 2015. There might also still be a case for supporting banks that expand their outreach in rural areas, despite the recent efforts of nonbank financial institutions to diversify away from Baku.

83. **Microfinance.** Accessbank and FINCA dominate the sector with a combined market share of nearly 50%. Both institutions are well established and capitalized, professional, and have proven access to foreign funds, even under crisis conditions. From a sector development point of view, it might therefore be better to more actively support smaller microfinance providers.[62] While ongoing donor efforts to support the downscaling of banks might invigorate competition, banks are ambivalent in light of the sheer number of targeted institutions: microfinance will almost certainly not be profitable in Azerbaijan for another 10–12 banks with limited experience in micro-lending. It might be better to focus on the smaller number of banks that have the experience and potential to compete with Accessbank, and medium-sized nonbank credit institutions with the potential to compete with FINCA. To ensure sound sector development, donor support is urgently needed to strengthen regulation and supervision. The Central Bank of Azerbaijan has been building capacity for supervision of nonbank credit organizations for only

[61] The establishment of an SME credit guarantee fund with German assistance (from the Gesellschaft für Internationale Zusammenarbeit) shortly before the recent crisis failed. However, the idea could be revisited.

[62] Accessbank owners, which are external funding agencies, should also be interested in Accessbank making progress with attracting funds at market conditions. Without a diversification of funding away from donor organizations, it might be difficult to ultimately divest Accessbank.

the past 3 years.[63] Even large microfinance organizations have yet to see their first on-site inspection.

84. **Insurance and leasing.** The government's reforms in the insurance sector are going in the right direction. However, external support is needed to further strengthen regulation, build capacity for supervision, and conceptualize reforms to invigorate competition and improve the quality of services. Azerbaijan has no lead development partner in the area of insurance. External development agencies could help address remaining policy, legal, and regulatory constraints for leasing, which is still hardly used by either banks or nonbank financial institutions.

85. **Business climate.** Finally, the importance of business climate reforms for financial sector development in Azerbaijan should not be underestimated. There is, for instance, scope for donor support in the areas of corporate governance and disclosure, bankruptcy procedures, and asset foreclosure, particularly for the implementation of existing laws and regulations.[64]

[63] An additional constraint is that banks tend to absorb the Central Bank of Azerbaijan's scarce supervisory resources.
[64] Private sector development constraints are discussed in a separate private sector assessment study.

APPENDIX: KEY PROJECTS OF MAJOR DEVELOPMENT PARTNERS

Partner	Project Name	Duration	Amount ($ million)
Banking			
ADB	Azerigasbank, Accessbank, Bank Respublika; loans and equity	2005	15.0
ADB	International Bank of Azerbaijan, subordinated loan	2007	20.0
ADB	Bank Respublika, subordinated loan	2007	10.0
ADB	Accessbank, credit line (planned)	2012	n.a.
EBRD	Unibank, equity investment (20% shareholding)	2003	n.a.
EBRD	Unibank, syndicated loan	2004	5.0
EBRD	Demir Bank Azerbaijan, equity investment	2005	1.6
EBRD	Technical assistance to partner banks of framework facility for micro, small and medium-sized enterprises	2005–2007	1.7
EBRD	Unibank, syndicated loan	2006	7.5
EBRD	Bank Respublika, cofinancing facility	2006	6.0
EBRD	Unibank, syndicated loan	2007	30.0
EBRD	Bank Respublica, syndicated loan	2007	14.0
EBRD	Demir Bank; micro, small, and medium-sized enterprises credit line	2009	13.0
EBRD	Unibank; senior loan, convertible bond, and equity	2009	37.0
EBRD	Accessbank, SME credit line	2012–2017	15.0
EBRD	Demir Bank, SME credit line	2012–2017	7.0
EBRD	Reintroduction of energy efficiency credit line (planned)	2012	n.a.
EBRD	Equity investment in additional bank (planned)	2012	n.a.
FMO	Subordinated loan for Unibank	2006–2013	5.0
FMO	Credit line for Unibank (mortgage loans)	2008	15.0
IFC	Access Bank, equity investment	2002	n.a.
IFC	AG Bank; senior loan, trade finance credit line, and equity	2006–2007	6.3
IFC	Strengthen financial market infrastructure (regional)	n.a.	n.a.
IFC	Azerbaijan Housing Program (mortgage facility)	n.a.	15.0
IFC	Demir Bank, mortgage and microfinance loan facility	2008	5
IFC	Demir Bank, trade finance credit line	2009	5
IFC	Unibank, trade finance credit line	2009	1.6
IFC	Bank Respublika, trade finance and SME credit line	2009	15.0
IFC	Accessbank, micro and small business credit line	2009	15.0
IFC	Improving mortgage finance legal framework and awareness (regional)	n.a.	n.a.
IFC	Strengthening nonperforming loans and risk management functions	n.a.	n.a.
IFC/EBRD	Rabitabank, equity investment (planned)	2012	n.a.
KfW	German Azerbaijan Fund I+II (revolving SME credit line for six banks)	1998–2011	13.0
KfW/DEG	Unibank, equity investment and SME credit line	2005	7.5
KfW/DEG	Bank Respublika, equity and SME credit lines	2005	26.0
KfW	Institutional Development of Azerbaijan Deposit Insurance	2007–2010	1.4
KfW/DEG	Unibank; senior loan, convertible bond, and equity	2009	15.6
KfW	Recapitalizing Azerbaijan Deposit Insurance Fund	2010	6.5
KfW/DEG	Unibank, convertible bonds	2011	7.5

KfW	German Azerbaijan Fund III	2012	n.a.
EU[1]	Azerbaijan Bank Training Center (TACIS)	2000-	n.a.
USAID	SME finance program, credit line and capacity building for Shorebank	2002-2005	2.0
USAID	Support to the National Bank of Azerbaijan in banking supervision	2002-2004	3.0
USAID	Support for Central Bank of Azerbaijan in anti–money laundering, risk-based supervision, and financial management	n.a.	n.a.
USAID	Azerbaijan Competitiveness and Trade Project; capacity building for banks	2010-2013	n.a.
USAID	Development Credit Authority Program; guarantee for Accessbank and Demir Bank loans to rural SMEs; two other banks might be included later	2010-2015	3.3
World Bank	Financial sector technical assistance (for the Central Bank of Azerbaijan and Ministry of Finance)	2001-2006	5.4
World Bank	Financial Services Development (payment system and Aze Post)	2005-2010	12.3
Microfinance			
EBRD	Accessbank, equity investment and senior loan	2001	4.8
EBRD	Accessbank, syndicated loan	2008	40.0
	Accessbank, senior loan	2011	25.0
IFC/FMO	Supporting Microfinance Transformation Process	2008	n.a.
IFC	MSME credit line for Kredagro	n.a.	n.a.
IFC/SECO	Private Credit Bureau Development Project (REG) under the Azerbaijan–Central Asia Financial Markets Infrastructure Advisory Services Project	2009–present	n.a.
USAID	Rural Credit Project	2000–2005	5.9
Securities Markets			
EU	Legal approximation in the field of securities markets (TAIEX)		n.a.
EU	Study visit on settlement and clearing methodology (TAIEX)		n.a.
EU	Workshop on operational risk management systems (TAIEX)		n.a.
FIRST	Capital Market Development Plan	2010	n.a.
World Bank	Capital Market Modernization Project	2011–2015	12.0
SECO	Capital Market Modernization Project	2011–2015	1.6
Others			
ADB	Private banks and leasing companies in Azerbaijan	2006–2009	4.0
EBRD	Equity investment in MBASK Insurance Company	2004–2010	1.0
EBRD	Technical assistance for capacity building in Unileasing	2006	0.3
EBRD	Loan for and equity investment in Unileasing	2006	3.7
FIRST	Technical assistance to draft insurance law	2008	n.a.
IFC/SECO	Azerbaijan Leasing Development Project	2003–2006	1.3
IFC/SECO	Primary Mortgage Market Development Project—Phase 1 (regional)	2005–2006	n.a.
IFC	Primary Mortgage Market Development Project—Phase 2 (regional)	2006	n.a.
IFC/SECO	Azerbaijan Corporate Governance Project	2009	5.0
KfW	Cadastre and Registration System Project	2000–2008	31.2
SECO	Support to Azerpost to improve country wide provision of financial services	n.a.	n.a.

[1] Since its establishment with EU support, the center has also received support from GIZ, IFC, JICA, KfW, USAID, and World Bank, and more recently from the Islamic Development Bank.

EU	Legal approximation in the field of insurance sector regulation (TAIEX)	2012	n.a.
USAID	SME Support through financial sector development, capacity building for financial institutions including AMFA and bank training center	2005–2008	5.3
World Bank	Financial Services Development Project	2005–2010	17.8
World Bank	Corporate and Public Sector Accountability Project	2008–2012	24.0
World Bank/International Monetary Fund	Financial Sector Assessment Program	2014	n.a.

n.a. = not available.

ADB = Asian Development Bank, DEG = German Investment Corporation, EBRD = European Bank for Reconstruction and Development, FMO = Netherlands Development Finance Company, KfW = Kreditanstalt fuer Wiederaufbau, IFC = International Finance Corporation, SECO = State Secretariat for Economic Affairs, SMEs = small and medium-sized enterprises, USAID = United States Agency for International Development.

Azerbaijan: Financial Sector Assessment

The report assesses Azerbaijan's financial sector and explores priority areas for reforms. Despite recent rapid development, the economy's relatively large size, and rising income levels, the financial sector is not mobilizing savings or financing investment as much as it could. In banking, which dominates finance, efficiency can be further increased. Nonbanking financial services are undergoing major initiatives to develop securities markets, but insurance, microfinance, and private pensions have yet to see similar reforms.

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