

AYAZ MUSEYIBOV, PhD in Economics

ANALYSIS AZERBAIJAN BANKING SECTOR: IN THE PERIOD OF TRANSITION TO THE BASEL PRINCIPLES

Abstract. *This article presents a comprehensive analysis of the problems and perspectives associated with the implementation of Basel III standards in the banking sector of Azerbaijan, which is a developing country. It emphasized the Basel principles and emphasized the importance of banks to strengthen their defense against various risks in view of their essential role in the national economy. Basel standards are important for all countries to increase the resilience of the global banking system, to encourage prudential demands and to create a predictable and transparent regulatory environment for internationally active banks. The purpose of transition to Basel standards stated in the "Strategy Roadmap for the years 2016–2020 on the development of financial services in the Republic of Azerbaijan". The aim is to present the results and to investigate the practical issues of the application of these standards in Azerbaijan. In the investigation, logical generalization and comparative analysis methods that evaluate the regulatory problems of the Basel standards are used, which is why it is encouraged by the Basel Committee. Article emphasizes the gap between domestic regulatory demands in Azerbaijan and those proposed by the Basel Committee, sometimes calculating domestic demands and indicators as harsher and higher in terms of quantity. The results show that the banking sector of Azerbaijan, in which banks are primarily dominant, has undergone significant development in the last ten years, especially in terms of adapting to global crises and increasing the resilience of the sector. However, the implementation of the Basel II and Basel III principles remains incomplete, dealing with various difficulties. Analysis shows that, although there is some progress in legislative reforms specifically aimed at compliance with Basel standards, there are naturally certain difficulties in the full acceptance and implementation of these standards in the domestic banking sector. Emphasizing the necessity of continuous strong actions to strengthen the regulatory base of the banking sector, the experience of risk management and the infrastructure to bring it into line with international standards. The paper concludes by emphasizing the need for continued efforts to strengthen the banking sector's regulatory framework, risk management practices, and infrastructure to align with international standards. Thus, article suggests a multi-faceted approach involving legislative amendments, enhanced risk-based supervision, development of financial market infrastructure, and strengthening of corporate governance in banking sector. The successful implementation of Basel III standards in Azerbaijan will not only enhance the resilience and stability of its banking sector but also contribute to the stability of the financial system of the country.*

Keywords: *Basel standards, control system, Azerbaijan banking sector, Risk management, Financial system development.*

INTRODUCTION

Banks have to strengthen themselves against all kinds of risks due to their important functions in the country's economy. Therefore, financial organizations need to correctly calculate the risk factor in their activities. It should be noted that an important factor that plays the role of protection in difficult situations of banks is their capital. Full, timely and consistent adoption and implementation of the Basel standards is essential for all countries. The main goals here are to increase the stability of the global banking system, promote confidence in prudential requirements, and create a predictable and transparent regulatory environment for internationally active banks. Therefore, the Basel Committee and its governing body, the Group of Central Bank Governors and Supervisors, have made full and effective implementation of the Basel

standards globally agreed upon as a high priority. The committee regularly focuses, monitors, and evaluates three dimensions, including timeliness of standards implementation, consistency, and results. The purpose of this research work is to review the Basel principles and study the practical issues of applying those standards in Azerbaijan. In the Strategic Roadmap for the development of financial services in the Republic of Azerbaijan, it was noted that solving liquidity and capitalization problems in 2016–2020, improving the legal and regulatory framework will create conditions for defining new goals for the development of the financial system in the period up to 2025. In this period, among other factors, the establishment of a financial system with risk management adapted to Basel III standards and adapting the banking sector to the requirements of Basel III standards is

intended. As a result, a significant increase in the size of the healthy loan portfolio and a decrease in the specific weight of non-performing loans (NPLs) are planned. In addition, it is envisaged to conduct diagnostics of risk management in the banking sector and compare it with Basel II / III principles in the aforementioned road map. In the next stage, it is planned to prepare a road map for the implementation of certain elements of the Basel standards and to determine the regulation mechanism of systemically important banks. It should be noted that certain works have been done in the relevant direction and a regulatory mechanism has been defined for systemically important banks. However, official information about the relevant diagnostic evaluation based on the Basel standards in the banking sector has not been disclosed. As a result of the work done in the relevant direction, the following financial depth (ratio of current loans to non-oil GDP) is set to be 60 % by 2020, and the NPL ratio is targeted to be reduced from the current 14 % to 8 % [1]. Thus, fully adapting the banking sector in Azerbaijan to Basel III standards by 2025 is envisaged in the relevant strategic road maps. Application of Basel II and Basel III principles in supervision practice in Azerbaijan have not yet been completed. Unlike European countries, which have consistently applied the relevant standards for more than 10 years, the simultaneous application of the standards of the regulatory documents constituting the Basel Agreement in the banking sector of Azerbaijan was accompanied by various challenges. Thus, in some cases, the requirements of the mega-regulator in Azerbaijan are stricter than the corresponding requirements of the Basel Committee. As an example, it is possible to show the requirements for capital adequacy ratios applied in different periods. At the same time, although capital conservation buffer is applied in the country, requirements for counter-cyclical capital buffer have not been determined within the framework of legislation. Also, the conducted analyzes show that there are new opportunities for qualitative development of banking sector regulation requirements.

LITERATURE REVIEW

Challenges of assessment of transition to Basel standards. The enhancements of Basel III over Basel II is mainly related to four directions such as augmentation in the level and quality of capital, introduction of liquidity standards, modifications in provisioning norms and introduction of leverage ratio [2]. The Basel Committee established a comprehensive Regulatory Consistency Assessment Program (RCAP) in 2012 to monitor and assess the adoption and application of

its standards while promoting a predictable and transparent regulatory environment for internationally active banks. The Basel Committee assesses the consistency and completeness of the adopted standards. Through the RCAP, the Committee seeks to ensure the full, timely and consistent implementation of the Basel III framework, thereby contributing to global financial stability. RCAP also supports the Financial Stability Board (FSB) in monitoring the implementation of G20 agreed financial reforms. Monitoring reports focus on the adoption of all Basel III standards in member jurisdictions to ensure that these standards are transposed into national laws or regulations in accordance with internationally agreed timelines. Jurisdictional assessments consider how well local regulations meet the minimum Basel requirements agreed by the Committee and help identify significant gaps in these regulations. Thematic assessments examine the implementation of Basel requirements at the individual bank level and seek to ensure consistent calculation of prudential ratios by banks across jurisdictions to improve comparability between outcomes. Jurisdictional assessments consider how well each member's jurisdiction's domestic regulations meet the minimum regulatory standards agreed by the Committee. The results of each assessment are published in a separate jurisdiction-specific report. The biggest achievement of Basel Committee members in adopting the Basel III rules is that today their 28 member jurisdictions manage majority of the world's banking assets [3].

Evaluating the macroeconomic effects of Basel III standards requires a correct definition of the relationship between the rules on capital requirements, the behavioral factors of banks and the real economy. However, studies show that there is no unified theoretical framework that determines the effects of regulatory requirements in this field, not only in Azerbaijan, but also globally [4]. Evidently, conducting assessments related to the implementation of Basel III standards requires access to extensive databases and detailed assessments, working with regulatory agencies in the field, which makes their scientific evaluation and monitoring difficult. At the same time, the continuous change of the standards from year to year due to the influence of new challenges arising on a global scale limits the possibility of comparability of the evaluation of their effects and monitoring their sequence.

Overview of banking supervision practices in Azerbaijan. The supervision system of the banking system of Azerbaijan is based on the compliance control method. Control measures conducted in the form of on-site inspection and

remote monitoring are based on various measurement methodologies such as capital adequacy, asset quality, management, profitability and liquidity, respectively, and are largely risk-averse [5]. It should be noted that the transition to a risk-based supervision system by 2020 is defined as one of the main goals in the relevant strategic road map for the financial sector and the state program for digital payments. However, it was not possible to fully apply the relevant approaches [6]. It should be noted that on February 3, 2016, all control activities in the banking sector, insurance and securities in Azerbaijan were for the first time assigned to the authority of a single control body, that is, the Financial Markets Supervisory Authority (FIMSA). Before the creation of FIMSA, the banking sector was controlled by the Central Bank of Azerbaijan, securities institutions by the State Securities Commission, and insurance companies by the Ministry of Finance. After the Decree dated November 2019, Central Bank became the sole regulatory body of the entire financial sector including capital markets, payment systems and insurance sector [7]. According to the reporting system currently established in the banking system, daily, monthly and quarterly reports from the banking sector are regularly received by the financial markets control body. These reports include statistical data on various areas, including loan portfolio data, equity positions, open currency positions, cash flow, cash flow, currency exchange, changes in deposits, etc. includes. Also, the teams operating in the control institution analyze the data revealed in the on-site inspections and the data of the official websites on a comparative basis with the submitted data, clarify the existing differences with the banks. The practice of preparing and publishing a special financial stability report on a periodic basis, which encourages all stakeholders to receive detailed information about the banking system of Azerbaijan and increase the level of transparency, is already being applied. By publishing this type of report on the official resources of the Central Bank, allows various participants of the financial market to better understand the state's expectations and strategic policy regarding the financial and banking system and its management [8].

Basel III transition in international experience. Certain studies' findings imply that, even though central banks can protect the banking system's financial stability by implementing macroprudential measures, it's crucial to consider how these measures may affect the actual economy's short-term swings [9]. It should be remembered that access to capital does not guarantee that banks will be financially stable, and that having more capital

is not a magic bullet when it comes to solving the problem of maintaining financial stability. Other factors that must be considered include the risk management system, the caliber of the assets, the caliber of the funding, the variety of the funding, and so forth. Just requiring banks to have more capital could potentially encourage banks to take on greater risk in order to maximize the return on their excess capital [2].

The process of transition to Basel standards on the European continent is widely discussed among the scientific and banking community from various aspects. In response to the global financial crisis and the challenges brought by Covid-19, the EU has initiated comprehensive banking sector reforms with the Basel III framework. The main goals of these reforms were to enhance the resilience of EU financial institutions, ensure comparability of risk-based capital ratios among banks, and address vulnerabilities. Basel III reforms with consideration for EU-specific factors, introducing explicit rules for managing ESG risks in line with the Sustainable Finance Strategy, and granting supervisory authorities enhanced powers for more effective oversight can be noted as the key components. Therefore, the reforms prioritize stability, competitiveness, and alignment with international standards, with an extended implementation period until January 1, 2025 and to manage pandemic-related financial risks and promote a smooth transition. Generally, the Commission's proposal for Basel III adheres to several fundamental principles. Faithfulness to international standards, preventing significant capital requirement increases, adjustments for EU specificities, preventing competitive disadvantages, coherence with banking union, proportionality and reduced compliance costs can be remarked in this regard [10].

The capitalization of the majority of Iranian non-state banks appears to be adequate based on their annual reports, but Basel III regulations — which allow for a much more accurate assessment of the risk of banks' assets — indicate that Iranian banks' capitalization is in a very critical situation [11]. Transition to the Basel III framework challenges for Indian banks, is in areas such as augmentation of capital resources, growth versus financial stability, challenges for enhanced profitability, deposit pricing, cost of credit, maintenance of liquidity standards, and strengthening of risk architecture. As a result, Indian banks will encounter many difficulties when implementing Basel III, particularly when it comes to increasing capital to meet more stringent adequacy standards and improving liquidity management to comply with even stricter regulations, which could have an effect on the banks' ability to grow and make money [2].

METHODOLOGY

The research is divided into a methodology devoted to problems related to Basel III standards in developing countries, paying attention to the banking system of Azerbaijan, and the regulation of enforcement issues. It essentially unites the complex of quality and quantity analysis methods aimed at providing a comprehensive analysis. Logical generalization, benchmarking analysis methods have been used in the research. Data from different local sources were used to analyse trends in Azerbaijani banking sector, especially from the Central Bank of Azerbaijan, Azerbaijani Banking Association and international databases. A broad compilation of existing literature was conducted and academic journals to understand the global context of Basel III implementation and its importance for bank stability and risk management, Basel Committee's reports and financial regulation acts were reviewed. Comparative analysis were used to evaluate compliance with international standards and identifying gaps in the preparation and reaction of the domestic banking sector of Azerbaijan. Azerbaijan's banking legislation including capital, liquidity and leverage demands and regulatory framework reforms were analysed comprehensively. These methods together offer a uniform view of Basel III transition problems in Azerbaijan, providing the possibilities of perfecting the regulation and a smooth and effective execution processes.

RESULTS

The structure of the financial system in Azerbaijan. Banks have a dominant position in the financial system of Azerbaijan. Non bank credit institutions are distinguished by their low share in the sector. The share of 8 investment companies in the financial system remains small. The assets of the insurance sector are about 1.5 billion AZN. According to the data up to the end of 2022, 19 insurance and reinsurance companies operate in the insurance market of Azerbaijan [12]. The activity of

the insurance sector was also ensured through 29 insurance brokers and 652 insurance agents. There are 23 banks, 19 insurance companies, 54 non-bank credit organizations, 40 credit unions and 1 national postal operator (Azerpost LLC) that carry out financial operations [13] (**Table 1**). Financial depth is below potential. For example, according to the results of the Global Innovation Index 2023 based on the specific weight of private sector loans in the total economy, Georgia ranks 43rd, Turkey 46th, Russia 61st, Uzbekistan 90th, Ukraine ranks 101st, ahead of Azerbaijan (106th rank) [14].

Development trends in the banking system of Azerbaijan. The banking sector of Azerbaijan has undergone substantial development over the past 10 years. In particular, the measures implemented in the direction of reducing the negative effects of the global crises on the economy of Azerbaijan had an important impact. The specific weight of loans in the national currency in Azerbaijan's banking sector has followed fluctuations over the past 10 years, decreasing from 64 % in 2010 to 50,6 % in 2015, and then reached to 81,3 % in the first 3 quarters of 2023. The volume of the total loan portfolio has increased more than twice (9,1 billion AZN in 2010, 23 billion AZN in the 3rd quarter of 2023) [15] (**Table 2**).

During the last 10 years, continuous reforms were carried out in the direction of increasing trust in the banking sector, as a result, the volume of deposits, which was 12,4 billion AZN in 2013, reached 36,2 billion AZN in 2022. The total amount of savings placed in the banking sector increasing by twice has reached 11,7 billion AZN in 2022 (6,3 billion AZN in 2013). The global oil price crisis and the Covid-19 pandemic had a negative impact on the banking sector, and there was a decrease in the volume of both deposits and savings in some years (2016, 2017 and 2020) [15] (**Table 3**).

Furthermore, dedollarization has increased with the influence of the reforms carried out in recent years. The share of foreign currency loans is higher in the business sector and is about 50 %.

Table 1

Structure of the financial sector

Name of the financial institution	Number
Banks	23
Non bank credit institutions	54
Insurance companies	19
Credit unions	40
Investment companies	13

Source: Central Bank of Azerbaijan.

Table 2

Structure of credit investment by currencies

Date	Total	Loans in national currency (volume)	Loans in foreign currency (volume)	Loans in national currency (weight in total portfolio)	Loans in foreign currency (specific weight in the total portfolio)
2010	9163,4	5865,3	3298,1	64,0 %	36,0 %
2015	21730,4	10994,5	10735,9	50,6 %	49,4 %
2016	16444,6	8663,1	7781,4	52,7 %	47,3 %
2017	11757,8	6953,6	4804,2	59,1 %	40,9 %
2018	13020,3	8073,6	4946,7	62,0 %	38,0 %
2019	15298,2	10000,8	5297,4	65,4 %	34,6 %
2020	14530,4	10204,0	4326,4	70,2 %	29,8 %
2021	17119,8	12696,5	4423,4	74,2 %	25,8 %
2022	20184,0	16194,3	3989,7	80,2 %	19,8 %
9 months of 2023	23018,6	18707,5	4311,2	81,3 %	18,7 %

Source: Central Bank of Azerbaijan.

Table 3

Total deposits and savings in Azerbaijani banking sector

Date	Total deposits (million manats)	Amount of total savings (million manats)
2013	12475,8	6395,8
2014	15453,4	7188,4
2015	23431,4	9473,9
2016	22091,0	7448,7
2017	20599,1	7561,2
2018	21870,4	8375,4
2019	24746,0	8637,9
2020	23666,9	8177,9
2021	29027,7	9241,5
2022	36249,8	11743,0

Source: Central Bank of Azerbaijan.

Calculations show that the level of concentration in the banking industry can be considered relatively higher than the average level. According to the results of the 3rd quarter of 2023, the share of 5 banks in the net profit of the banking sector was 79 %, in the deposit portfolio 77 %, in the loan portfolio 63 %, and the share in the total assets 72 %. In recent years, there have been no fundamental changes in the relevant trends, which indicates that the relevant trends are not so risky in terms of the future development of the financial and banking sector of the country. The share of foreign capital is less than 20 % of total assets in the banking system, and this share consists of

subsidiaries of foreign banks from Russia and Turkey and branches of foreign banks from Iran and Pakistan (now in the process of liquidation) [16].

It should be noted that the draft law "On Amendments to the Tax Code of the Republic of Azerbaijan" dated November 14, 2023 was submitted to the Milli Majlis of the Republic of Azerbaijan. According to the proposed amendments to articles 102.1.22-3 and 102.1.22-4 of the Tax Code, the part of the monthly interest income of individuals calculated on national currency deposits in each bank up to 200 manats is exempted from income tax. If the monthly interest income is over 200 manats, the tax is applied to the higher amount. In addition,

if the deposit of individuals in national currency is placed in each bank for a period of 18 months or more and the amount of the deposit is paid no earlier than 18 months, the full part of the calculated interest income is exempted from income tax for a period of 3 years [17]. Additionally, the above statistical analyzes also show that earlier the adoption of the Law of the Republic of Azerbaijan "On Full Insurance of Deposits" dated January 19, 2016 and the extension of the term of insurance of deposits to one year by the Law dated February 19, 2019, in times of crisis, the population of banks served to increase confidence in the sector. According to the relevant legal acts, all protected deposits within the specified annual interest rate limit for deposits, regardless of the amount, are fully insured for a period of four years. At the same time, in order to increase the attractiveness of deposits, the annual interest income paid by banks on the

deposits of individuals was exempted from tax for seven years from February 1, 2016, and all these steps prevented the trends towards the damaging of confidence in the banking sector [18].

In recent years, the total capital adequacy ratio of the banking sector has averaged around 20 % [19]. Based on the information disclosed by the banks, our statistical analyzes based on the publicly available data for the period of 2016–2023 show that there are significant differences between the banks in terms of the adequacy ratio of the total capital in the sector. Thus, there is a 15.3 times difference between the lowest and the highest indicator of the total capital adequacy ratio (10,56 %; 162,45 %) (**Table 4**).

Legislative reforms to align with Basel standards. In the "Rules for calculating bank capital and its adequacy" prepared according to

Table 4

Total capital adequacy ratio in the banking sector of Azerbaijan, 2016–2023

No.	Name of bank	Total capital adequacy ratio (average, 2016 Q1-2023 Q3)
1	"AZƏR-TÜRK BANK" ASC	24.41
2	"AZƏRBAYCAN BEYNƏLXALQ BANKI" ASC	26.31
3	"AZƏRBAYCAN SƏNAYƏ BANKI" ASC	17.38
4	"ACCESSBANK" QSC	10.56
5	"BANK OF BAKU" ASC	19.51
6	"PAŞA BANK" ASC	14.79
7	"KAPITAL BANK" ASC	15.98
8	"XALQ BANK" ASC	19.54
9	"ZİRAAT BANK AZƏRBAYCAN" ASC	26.86
10	"EXPRESSBANK" ASC	37.70
11	"BANK AVRASIYA" ASC	57.80
12	"AFB BANK" ASC	40.40
13	BANK "BTB" ASC	26.87
14	"BANK RESPUBLIKA" ASC	12.60
15	"PREMIUM BANK" ASC	31.48
16	BANK VTB(AZƏRBAYCAN) ASC	44.03
17	MELLI IRAN BANKI BAKI FILIALI	162.45
18	"NAXÇIVANBANK" ASC	59.78
19	"YELO BANK" ASC	17.24
20	"RABİTƏBANK" ASC	18.56
21	"TURANBANK" ASC	18.00
22	"UNİBANK" ASC	12.74
23	"YAPI KREDİ BANK AZƏRBAYCAN" QSC	31.84

Source: Calculated by the author based on the data of the Azerbaijan Banks Association. — Access mode: <https://aba.az/banklar/renkingl%c9%99r/>.

the recommendations of the Basel Committee and approved on November 16, 2018. The differential normative requirements for systemically important banks have been defined within the “Rules on the regulation of credit risks for one borrower or a group of borrowers related to each other”. Furthermore, additional prudential requirements have been applied for the banks first time:

- it has been requested from banks to raise the adequacy ratio of the total capital from 10 % to 11 % from June 1, 2019, and to 12 % from January 1, 2020;
- it has been requested to increase the adequacy ratio of Tier I capital from 5 % to 5.5 % on June 1, 2019, and to 6 % on January 1, 2020. It should be noted that in accordance with the requirements of Basel III standards, the minimum leverage ratio is 3 %. However, depending on the specifics of the country, a stricter leverage requirement may be imposed by the local supervisory authority;
- the leverage ratio is set at 5 % for systemically important banks, and 4 % for other banks.

On May 1, 2020, the Rules for calculating Bank capital and its adequacy were updated [20]. Also, taking into account the recommendations of the Basel Committee, changes were made to the “Standards of Corporate Governance in Banks” [21]. The new Standards were developed taking into account the Basel Committee and the experiences of advanced countries. Examples of major legislative changes based on Basel standards include:

- on the main duties of the bank's shareholders and administrators,
- on risk management issues,
- corporate governance issues, etc.

Thus, minimum higher requirements for capital adequacy ratio and leverage ratio are defined for systemically important banks in the banking legislation of Azerbaijan. In addition, with the new rules, a counter-cyclical capital buffer of 0–2.5 % has been applied to Tier I capital and total capital adequacy ratio, depending on the economic cycle and the growth rate of the loan portfolio [20].

According to the Rules on Banks' Liquidity Management, the regulations on the instantaneous liquidity ratio in the country are that banks must keep the ratio of the average daily price of highly liquid assets to the average daily amount of highly liquid, i.e. current liabilities, at least 30 %. National legislation requires banks to analyze their liquidity, and at this time, the ratio of highly liquid assets to total assets, the ratio of current assets to highly liquid (current) liabilities, that is, the current liquidity ratio, the ratio of highly liquid (current) liabilities to the total amount of assets, the ratio of loans to

deposits ratio etc. At this time, in order to predict the liquidity position, they are not returning loans on time or delay, decrease in the volume of liquid assets, observing changes in the value of liquid assets in the market, changing the currency of customer deposits, recalling large deposits, premature recall of funds received from banks and other financial institutions, interest they should carry out a stress-test of the liquidity situation not less than once a month based on assumptions such as the change in the interest rate, the change in the inflation rate, and the sharp change in the exchange rate [22]. According to the 2023 “Regulation on Liquidity Risk Management in Banks”, the regulations on liquidity risk such as the identification and assessment of liquidity risk in the banking system, at least “gap” analysis, concentration of sources of funds involved, instant liquidity ratio, liquidity coverage ratio, is implemented through an early warning system and stress tests [23].

Conditions for the transition to Basel III in Azerbaijan. Our conclusion based on international experience shows that the conditions for the transition to Basel III standards are partially met in Azerbaijan. Thus, it is possible to explain the faster and smoother transition to Basel III standards, especially in developed countries, by the fact that the financial sector of these countries has more stable and fundamental capabilities. From this point of view, high financial depth, high level of internationalization, satisfactory level of regulation of the sector, existence of institutional and infrastructural elements such as credit register and rating agencies in the sector, existence of developed capital markets are of special importance. For example, one of the reasons why Singapore implemented the Basel III standards sooner and more fully than the Basel Committee's timeline was because the country has a highly developed banking sector [24]. The conducted analyzes have also shown that there is a strong correlation between indicators of the depth of the financial sector and the adoption and implementation of Basel II and III standards. In addition, the internationalization of the banking sector in the country, the quality of banking sector regulation and approaches to the regulation of the sector in general also play an important role in the adoption of these standards. In general, the analysis of the certain conditions and criteria such as presence of a well-developed financial market infrastructure, high financial depth, the degree of internationalization of the banking sector, the quality of banking sector regulation, approaches to sector regulation, the functioning and strong influence of institutional institutions, credit information exchange agencies, central credit registries, show that the current opportunities related to the

application of Basel III standards in Azerbaijan are satisfactory and have opportunities for development [25].

Opportunities for development in the application of Basel III standards in Azerbaijan.

Capital requirements have been tightened in the banking sector of Azerbaijan in recent years, and at the same time, new tools for managing liquidity risks have been defined. In order to mitigate the effects of systemic risks and manage them, the creation of a countercyclical capital buffer and differential regulatory requirements for systemically important banks have been defined. In recent years, important work has been done in the direction of the application of the automated, dynamic prudential control system. The work of adapting the normative base level of bank supervision to the principles of the Basel Committee is currently being continued [26]. In general, legislative, institutional and infrastructural measures are implemented by the Central Bank in the direction of increasing trust in the banking system, strengthening management potential in the banking sector, minimizing system risks and strengthening and increasing financial stability [27].

The conducted studies show that there is a high possibility of improving the provisions related to the corporate governance of banks in the sector, based on the Basel III principles. For example, the selection requirements for supervisory board members and executives could be strengthened, taking into account the best international practices and the requirements of the Basel Committee. The law on banks in Azerbaijan was adopted in 2004, and in this regard, considering the requirements of the modern era, there are opportunities to make fundamental changes in the relevant laws in addition to making additions and changes to individual rules. Thus, the law on banks can cover progressive regulatory issues according to the principles of the Basel Committee on supervision, i.e. early intervention, consolidated supervision, risk-based supervision, etc. in more detail. At the same time, there are also opportunities for cooperation and joint control practices with foreign banks regarding the licensing of subsidiaries of foreign banks or local branches of foreign banks. Since several foreign banks have branches in the country and some of the country's banks have subsidiaries abroad, consideration of cross-border control issues is also relevant. In this regard, there are also opportunities for closer coordination regarding the exchange of regulatory information with the relevant supervisory authorities of foreign countries. It should be noted that the current banking supervision framework does not include consoli-

dated supervision. As regulations are mainly based on a form of compliance control, it is difficult to take control measures based on risk assessment. Therefore, as part of a full transition to risk-based supervision, the regulations may be revised and adapt to risk-based supervision approach in line with international best practices. Currently, there are banks in the country that form a group as subsidiaries of holding companies. The competent authority does not have the authority to implement consolidated supervision, impose reserve requirements or take mandatory enforcement measures related to consolidation. As the competent regulator of banks, non-bank financial institutions, insurance companies and capital market institutions, it would be useful to improve the legislation in the form that would allow regulator to exercise consolidated control over financial groups at the initial stage [28]. Also, currently, regulatory requirements such as capital adequacy, liquidity and risk limits are not set on a consolidated basis, which require the implementation of methodologically important measures. Taking into account the requirements of the modern era and the criteria of the Basel Committee, risk-based control approach can be depicted the Law "On Banks". Accordingly, it is considered appropriate to cancel the rule on on-site inspections, which stipulates that bank control inspections will be conducted once a year in the current legislation. The quality of regulation would also be higher if the frequency of inspections is determined depending on the control strategy that combines comprehensive and targeted on-site inspection methods with external control, taking into account the risk profile and specific nature of banking operations for each bank [5].

CONCLUSION

International experience shows that when applying Basel III standards, local economic conditions and strategic goals are taken into account, and a transition to these standards that is not as strict as possible is preferred. The implementation of the Basel III standard in Azerbaijan should be based on foreign experience in a special way. Thus, the improvement of the regulatory and control system of the banking sector and the strengthening of the management of risk factors can be ensured by implementing the successful aspects of foreign country models. The reform measures to be prepared should be implemented with a detailed action plan, possible risks should be taken into account. In order to realize the objectives set in the implementation of Basel III standards, the right strategic goals should be selected. If Basel III standards are fully implemented in Azerbaijan by 2025, as stipulated in the relevant state documents,

this will at least help to expand risk management practices in banks by adapting credit risk assessment mechanisms, scoring models, corporate governance structures and risk management processes to international standards. Since 2018, the existence of a credit bureau in the country that meets Basel III standards and provides banks with high-quality data will allow financial institutions to anticipate potential losses on overdue debts, improve underwriting and monitoring systems. As a result, the size of the healthy loan portfolio will increase significantly, and the share of bad loans will further decrease.

Evaluation the implementation of Basel standards in the banking sector of Azerbaijan reveals the need to strengthen financial stability and harmonize international regulatory frameworks. With a view to respond adequately to the difficulties associated with the acceptance of Basel II and III principles, important steps need to be taken, especially towards strengthening the regulatory framework in the country and mitigating transition risks. Strategy road map for the development of financial services in Azerbaijan, specifically aimed at solving liquidity and capitalization issues from 2016 to 2020. It has created the basis for the future development of the financial system. Attention is paid to perfecting risk management experiences in accordance with Basel III standards and fundamental change towards a more resilient banking sector. However, the journey towards full implementation and harmonization of the Basel standards also requires more robust infrastructure including greater financial depth and risk-based management practices. Thus, by implementing these recommendations, Azerbaijan can further align its banking sector with international standards, increase its banking sectors resilience and enhance the overall stability of its financial system:

- Re-examining the legislative and regulatory base in order to fully comply with Basel III standards, including capital development, risk management and liquidity requirements and continue its renewal which will involve both correcting existing laws and implementing new regulations to eliminate any gaps in compliance;
- A fully integrated risk-based monitoring approach need to be introduced, which allows for more dynamic and sensitive monitoring of banks' risk profiles. This includes on-site inspections and increasing monitoring capabilities to better identify, evaluate and reduce potential risks to the banking sector;
- Give priority to the development of a more robust financial market infrastructure that supports the successful activity of the banking

sector. For instance, improving access to high-quality data, improving credit registers or bureaus, and increasing the effectiveness of public services of the financial market;

- Continue to strengthen corporate governance frameworks in banking system to manage risks;
- Promoting greater transparency and disclosure of information according to the Basel principles may increase public confidence and trust in the banking sector;
- Participation in international forums and working groups can facilitate the exchange of experience and ideas;
- Introduce potential development and training programs for both regulators and banks to deepen their understanding of the Basel standards and their practical application including specific exercises and trainings on risk management, capitalization and stress testing.

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Аяз МУСЕЙБОВ, канд. екон. наук

АНАЛІЗ БАНКІВСЬКОГО СЕКТОРА АЗЕРБАЙДЖАНУ НА ПЕРІОД ПОЧАТКУ ПЕРЕХОДУ ДО БАЗЕЛЬСЬКИХ ПРИНЦИПІВ

Резюме. У статті представлено комплексний аналіз проблем і перспектив, що пов’язані з упровадженням стандартів Базель III у банківському секторі Азербайджану, який належить до категорії країн, що розвиваються. Автором окреслено Базельські принципи і наголошено на важливості посилення захисту банків від різних ризиків через їх важливу роль у національній економіці. Базельські стандарти важливі для підвищення стійкості глобальної банківської системи, заохочення пруденційних вимог і створення передбачуваного та прозорого нормативного середовища для банків, що діють на міжнародному рівні. Мета переходу на Базельські стандарти визначена у «Стратегічній дорожній карті на 2016–2020 роки щодо розвитку фінансових послуг в Азербайджанській Республіці». Таким чином, важливо представити результати та вивчити практичні питання щодо застосування цих стандартів в Азербайджані. У дослідженні використувалися методи логічного узагальнення та порівняльного аналізу, які оцінюють проблеми регулювання Базельських стандартів. У статті наголошено на розриві між внутрішніми нормативними вимогами в

Азербайджані та вимогами, запропонованими Базельським комітетом. Зазначено, що іноді внутрішні ви-
моги та показники можна визначити як більш жорсткі. Окрім того, наголошено на їхній значній кількості. Ре-
зультати показують, що банківський сектор Азербайджану впродовж останніх десяти років зазнав значного
розвитку, особливо щодо адаптації до глобальних криз і підвищення стійкості сектора. Проте автор вказує
на труднощі, що пов'язані з реалізацією принципів Базель II і Базель III, яка нині залишається незаверше-
ною. Аналіз показує, що, хоч і є певний прогрес у законодавчих реформах, спрямованих на досягнення
відповідності Базельським стандартам, принципи поки не розроблено. Окрім того, існують певні труднощі
в повному прийнятті та впровадженні цих стандартів у внутрішньому банківському секторі. У статті на-
голошено на необхідності постійних рішучих дій щодо зміцнення нормативної бази банківського сектора,
а також напрацювання досвіду управління ризиками та інфраструктури для приведення його у відповідність
до міжнародних стандартів. Таким чином, у статті запропоновано багатогранний підхід, що передбачає по-
правки до законодавства, посилення ризико-орієнтованого нагляду, розвиток інфраструктури фінансового
ринку та посилення корпоративного управління в банківському секторі. Успішне впровадження стандартів
Базель III в Азербайджані не лише підвищить стійкість і стабільність його банківського сектора, а й сприя-
тиме стабільності фінансової системи країни.

Ключові слова: Базельські стандарти, система контролю, банківський сектор Азербайджану, управління
ризиками, розвиток фінансової системи.

INFORMATION ABOUT THE AUTHOR

Museyibov Ayaz — PhD in Economics at Azerbaijan State University of Economics (UNEC), Azerbaijan, Baku, Is-
tiqlaliyyat Str., 6, AZ1001; Adjunct lecturer at Azerbaijan Technical Univeristy (ATU), ayaz.museyibov@unec.edu.az;
rafigoglu.ayaz@gmail.com; ORCID: 0009-0000-9635-4935

ІНФОРМАЦІЯ ПРО АВТОРА

Мусейбов Аяз — канд. екон. наук, Азербайджанський державний економічний університет (UNEC), Азербайд-
жан, Баку, вул. Істіклаліят, 6, AZ1001; ад'юнкт-викладач Азербайджанського технічного університету (АТУ) ayaz.
museyibov@unec.edu.az; rafigoglu.ayaz@gmail.com; ORCID: 0009-0000-9635-4935



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