Center for Analysis of
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AZERBAIJAN ECONOMIC REFORMS REVIEW

MAIN DIRECTIONS (PROGRAM) OF THE UTILIZATION OF THE ASSETS OF THE STATE OIL FUND OF THE REPUBLIC OF AZERBAIJAN AND ITS INVESTMENT POLICY FOR 2017

“Main directions (program) of the utilization of the assets of the State Oil Fund of the Republic of Azerbaijan and its investment policy for 2017” was approved by the Decree of the President of the Republic of Azerbaijan, dated 12 May, 2017.

According to the approved program, directions of expenditures of the State Oil Fund of the Republic of Azerbaijan are as follows:

- Financing the several measures on social condition of refugees and IDPs (internally displaced person);
- Transfer to 2017 State Budget of the Republic of Azerbaijan;
- Transfer to the Central Bank of the Republic of Azerbaijan for ensuring macroeconomic stability;
- Financing the reconstruction of the Samur-Absheron irrigation system;
- Financing "Baku-Tbilisi-Kars railway" project;
- Financing the "State Program on the Education of Azerbaijani Youth abroad in 2007-2015 period";
- Financing the share of the Republic of Azerbaijan in Southern Gas Corridor projects.

Investment policy of the State Oil Fund of the Republic of Azerbaijan

In 2017, the purpose of the investment policy of the Republic of Azerbaijan is to implement an investment policy aimed at maximizing return while minimizing the probability of substantial losses by the State Oil Fund of the Republic of Azerbaijan (hereinafter referred to as "Oil Fund"). The total value (weighted average size) of the investment portfolio of the Oil Fund in 2017 is forecasted at 51.2 billion AZN.

USD is the base currency of the investment portfolio of the Oil Fund. In total 90% of the total value of the investment portfolio of the Oil Fund could be composed of the following currencies provided that the credit rating issued by international credit agencies is not less than "A" (based on Standard & Poor`s, Fitch credit rating scale) or"A2" (based on Moody's credit rating scale):

- 50 % invested in assets denominated in USD;
- 35 % invested in assets denominated in EUR;
- 5 % invested in assets denominated in GBR;
- Remaining 10 % invested in assets denominated in other currencies.

Investment portfolio of the Oil Fund (hereinafter– Portfolio) consists of the following sub-portfolios as well:

- Debt obligations and money market instruments portfolio – 60% of the total value (portfolio) along with maximum lower deviation of 5% (up to 5% composed of stock funds investing in equities);

- Equity portfolio – up to 25 percent of the total value of investment portfolio (up to 5% composed of stock funds investing in equities);

- Real estate portfolio – up to 10% of the Portfolio along with maximum upper deviation of 2%;

- Gold portfolio – up to 5% of the Portfolio along with maximum upper deviation of 3%.

Benchmark of the investment portfolio

- The benchmark of the debt obligations and money market instruments portfolio (excluding assets denominated in Euro) is 6 (six) months LIBOR (interest rate published by the British Bankers' Association) for corresponding currencies.

- The benchmark for the EURO denominated assets in the debt obligations and money market instruments portfolio in 6 (six) month EURIBOR.

- The benchmark for the currencies without any corresponding LIBOR can be a widely used 6 (six) months interest rate that banks charge each other for money interbank deposits.

- The benchmark for the equity portfolio is MSCI Stock Market Index.

Risk management requirements

Interest rate risk: The actual weighted average investment duration of the debt obligations and money market is determined by the Oil Fund depending on the current situation in the global financial markets and should not exceed 48 months.

Credit risk. Credit rating of investment assets where foreign exchange assets of the Oil Fund is reserved and the requirements for upper limit of the special weight of 5 percent for debt obligations with non-investment rating and deposits in financial structures set in paragraph eight of the Clause 3.3 of the "Rules on management of foreign currency assets of the State Oil Fund of the Republic of Azerbaijan" approved by the Decree of the President of the Republic of Azerbaijan №511 dated June 19, 2001 shall not apply to the assets of the Oil Fund included into its investment made for the purpose of implementation of the measures set by the acts of the President of the Republic of Azerbaijan.

In addition, the maximum average weight of one specific security or one issuer (excluding depository banks) in the Portfolio should not exceed 15% of the total value of the Portfolio.

Liquidity requirements. Liquidity of the Oil Fund's assets should be at a reasonable level in order to ensure accurate and timely execution of planned money and other transfers related to budgetary expenditures of the Oil Fund. To ensure this level, a part of assets equivalent to not less than USD 100 million (minimum liquidity level) should be kept in short-term money market instruments with high liquidity. If minimum liquidity level is reached, it should be restored within 7 (seven) calendar days.

Requirements with respect to external managers. The credit rating of the involved external manager or his/her subsidiary should not be less than the investment-level credit rating of international credit agencies (Standard and Poor's, Fitch or Moody) or should have at least 5 years of positive experience and competency in management of assets with a value of not less than USD 1 (one) billion.

Furthermore, the maximum allocation to external managers should not exceed 60% of the total value of the Portfolio. The maximum allocation to one external manager should not exceed 5% of the total value of the Portfolio. Assets of the Oil Fund allocated to the World Bank to be managed within the RAMP program should not exceed USD 500 million.

It is also worth to note that the responsibilities of external managers involved in management of the assets of the Oil Fund and the period set for management should be reflected in the agreement signed between the Oil Fund and the managers.

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