CENTRAL BANK OF
THE REPUBLIC OF ARMENIA

ARMENIAN FINANCIAL SYSTEM

2008

DEVELOPMENT
REGULATION
SUPERVISION

2009

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INTRODUCTION

In 2008, the Armenian financial system development and growth continued, and displayed high flexibility in spite of the difficulties observed at the end of the year.

Despite the turbulences in the global financial market, the financial system development in the first three quarters continued at the same rate as in the previous year. The negative impacts of the global recession penetrated into the Armenian financial system only in the fourth quarter of the year, as the economic growth significantly slowed down throughout the real sector.

Macroeconomic development patterns varied in the course of the year, while in the first three quarters the double-digit growth manifested in the previous years still continued, household income growth, foreign trade volumes and the economic growth in the fourth quarter slowed down. Subsequently, economic growth in 2008 totaled 6.8 percent, which was twice lower compared to the double-digit 13.7 percent growth of the previous year. Sharp drop down was observed in construction sector, which was mainly caused by contained private financing and contraction of the state budget allocations. In 2008, the growth of remittances (particularly in the fourth quarter) and household income decreased and uncertainties in terms of the future economic outlook were increased. The fall in the household income growth contributed to the drop in the growth of the services sector.

In 2008, trends of financial intermediation expansion manifested in the previous year have slowed down. The share of the banking system assets and loans within GDP grew by 3.6 and 3.9 percentage points totaling 28.0 and 16.9 percents respectively. Banking system deposits/GDP ratio fell by 0.4 percentage points and totaled 12.3 percent. Further expansion of financial intermediation was hindered by negative expectations and impacts of the crisis starting from the last quarter of the year.

Banking system continues to play a predominant role within the financial system, with the share of banking assets within the financial system totaling around 92 percent

The major indicators of the banking system in 2008 are as follows:

- Compared to the previous year, the lending growth rate fell, however it remains at a high level of 51 percent.
- Given the growth of lending, net foreign assets of the banking system continued to decrease and by yearend were equal to AMD -147 million.
- The level of dollarization surged (in the fourth quarter solely), driven by the expectations of dram depreciation, as a result of which the share of the AMD denominated assets and liabilities fell by 3.4 and 6.8 percentage points, totaling 60.6 and 44.9 percent respectively.

- Because of the global financial and economic crisis, and given the existing uncertainties regarding outlooks, commercial banks have tightened credit terms, which in turn contributed to a further decrease of credit growth.
- Compared to the end of the previous year, the share of non-performing loans within the total loans grew by 2.0 percentage points and totaled 4.4 percent.

Due to the statutory capital replenishments and high annual profits, Armenian banking system has increased the capital.

FINANCIAL MARKET SUPERVISION AND REGULATION

One of the major goals of the CBA is to ensure stability, liquidity, solvency and soundness of the financial system, create necessary conditions for development and sound performance of clearing systems, create proper conditions for coordinated operation and future development of a fair, transparent and sustainable securities market, as well as protect interests of the investors and consumers of financial services.

To achieve these goals, the CBA is vested with regulatory and supervisory powers by laws "On Central Bank", "On Introduction of the Unified System of Financial Regulation and Supervision" and other laws regulating the financial system.

Organization of the Financial System Supervision and Regulation in the CBA

Financial system supervision and regulation in the CBA is mainly performed through the following hierarchy (in the ascending order):

1. Structural Subdivisions,
2. Standing committees,
3. CBA Chairman,
4. CBA Board.

1. Objectives and functions of the CBA financial supervision and regulation units

The Central Bank units responsible for financial supervision and regulation, are Financial Supervision Department, Financial System Policy and Analysis Department, Statistical Department and Legal Department.

The main objectives of the Financial Supervision Department are:

- Supervision of the activities of financial institutions operating within the Republic of Armenia (banks, branches of foreign banks, credit organizations, insurance companies and intermediaries, branches of foreign insurance companies, participants of the securities market, pawn shops, persons performing foreign exchange trade operations, persons performing foreign exchange trade dealer/broker operations and other persons licensed by the Central Bank) and, in cases described by law, supervision of the activities of persons publicly offering securities and public offerers.
- Supervision of the activities of banks, insurance companies, credit organizations and securities market specialized entities undergoing liquidation process (self liquidation).

- Protection of the rights and lawful interests of the investors in the Republic of Armenia securities market and entities using investment services.
- Ensure the operation of a credible securities pricing system, a settlement system for securities transactions, and a system to register and file ownership rights over securities by means of discovering, evaluating, and preventing risks in the system.
- Ensure the transparency of operations of securities market specialized participants and securities issuers.

The main objectives of the Financial System Policy and Analysis Department are.

- Improve and/or develop and implement an efficient supervision methodology to mitigate risks in the financial system;
- Monitor the development trends of Armenia's financial system and to distinguish and evaluate existing and potential risks and obstacles for financial stability;
- Improve and/or develop an adequate regulatory framework and a structured methodological basis for mitigating bank (also, non-bank financial institution)risks and ensuring their sound operation;
- Improve and/or develop institutional elements (relations, instruments, methods, models and approaches) favorable for deepening financial intermediation and developing the financial system in accordance with the standards accepted by international banking (and non-bank financial institutions);
- Keep track of the current trends, developments and new financial technologies in global financial markets and develop appropriate recommendations on their possible implementation in Armenia's financial system.

The main objectives of the Legal Department are:

- Ensure the conformity of normative and individual legal acts adopted by the Central Bank with the provisions of the Republic of Armenia legislation;;
- Ensure the conformity of the Central Bank's transactions and operations with the requirements of the Republic of Armenia legislation;
- Protect interests of the CBA in the domestic and foreign courts;
- Organize and implement licensing and registration of banks operating within the Armenia, subsidiaries of foreign banks, credit organizations, insurance companies, subsidiaries of foreign insurance companies, participants of the securities market, pawn shops, persons performing foreign exchange trade operations, persons performing foreign exchange trade dealer/broker operations and other persons licensed by the Central Bank and their territorial branches, as well as carry out qualification and registration of the managers of above mentioned financial institutions;

- Facilitate development and improvement of the legislation regulating the Republic of Armenia banking, foreign exchange, insurance systems and securities market, as well as other laws and regulations relating to the activities of the Central Bank, systematize normative regulations of the CBA and develop proposals for their classification;
- Provide legal support for the Central Bank's international relations.

The main objectives of the Statistical Department are:

- Collect and process economic statistical data, perform statistical analysis (smoothenings, classifications, forecasts, calculations of various indices, etc.);
- Ensure consistency of the economic statistical data within the scope of competencies of the Department;
- Present collected and processed information to the general public through statistical and other publications of the Central Bank;
- Ensure and coordinate information flows between the CBA divisions and other organizations (including international organizations and foreign organizations);
- Conduct statistical surveys for analyzing certain developments (if needed on regular basis);
- Ensure that the information provided by lenders to the Credit Registry is accurately entered, processed and provided to users, and develop Credit Registry;

Based on their main objectives, the aforementioned departments perform the functions stipulated by their respective charters.

2. The CBA Standing Committees

Implementation of the financial system supervision and regulation functions is supported by two of the CBA standing committees:

- The CBA Council
- Licensing and Supervision Committee

The CBA Council

The CBA Council is a consulting body under the CBA Chairman. Regular sessions of the Council are usually convened once in every two weeks.

The Council members are the CBA Chairman, the CBA Deputy Chairman and heads of the divisions. The Council sessions are chaired by the CBA Chairman, and in the event when the Chairman is absent, by the CBA Deputy Chairman.

The Council sessions are convened at least once in a month. The Council sessions may be attended by the CBA Board members. The issues that will be discussed by the Council members during the session are in advance shared with the CBA Council.

Licensing and Supervision Committee

Licensing and Supervision Committee is a counseling body and is authorized to provide opinions within the scope of its competencies.

Licensing and Supervision Committee exercises its authorities through sessions, which are convened upon necessity, but no less than once a week. Licensing and Supervision Committee discusses:

- ✓ Matters related to the granting of preliminary approval to create financial organizations and the registration and licensing of such organizations;
- ✓ Matters related to the approval of registration and termination (or suspension) of operation of financial organizations' branches and representative offices;
- ✓ Matters related to the registration of amendments to the by-laws of financial organizations;
- ✓ Matters related to the qualification and professional conformity of financial organization managers (with the exception of heads of structural subdivisions);
- ✓ Matters related to the preliminary approval on acquisition of qualifying or other holding in the financial organization;
- ✓ Matters related to the reorganization and liquidation of financial organizations;
- ✓ Matters related to the registration of Prospectus and Trade Prospectus;
- ✓ Matters related to the suspension of the securities placement, as well as suspension and termination of the trade with securities;
- ✓ Matters related to the rules of the regulated securities market and Central Depository, their amendments and addenda;
- ✓ Matters related to the violations identified during the supervision of financial institutions, or other regulated persons, feasibility of imposing sanctions against them, types of sanctions;
- ✓ Other matters over which the Central Bank has legal authority in accordance with other legal acts.

Members of the Licensing and Supervision Committee are the CBA Chairman (Committee Chairman), the CBA Deputy Chairman (Committee Deputy Chairman), Head of the CBA Financial Supervision Department, Head of the CBA Financial System Policy and Analysis Department and Head of the CBA Legal Department.

A session of the Committee has legal power to act, if more than half of the Committee members are present. The committee sessions are minuted. Minutes of the session should be prepared within six working days after the day of the session and signed by all members of the committee. Resolutions of the session are taken based on the results of the open voting, by two thirds of voices of the committee members present at the session. Resolutions of the session, depending on the level of authority stipulated by law and other legal acts, should be submitted to the CBA Chairman or the CBA Board,

3. The CBA Chairman

The Chairman is the highest rank official of the Central Bank. The Chairman is responsible for the fulfillment of the objectives of the CBA set forth by "Central Bank Law".

The Chairman of the CBA shall:

- coordinate and organize the work and ensure the soundness of the activities of the Central Bank, the Board and the Board members,
- take the chair of the Board sessions, and sign acts and session protocols of the Board of the Central Bank,
- ensure execution of the acts of the Board of the Central Bank,
- represent the CBA in the Republic of Armenia, other states and international organizations,
- issue powers of attorney,
- approve the structure of the CBA and the staff,
- appoint and dismiss heads of units and other employees of the CBA, unless otherwise stipulated by "Central Bank Law",
- adopt individual and internal resolutions and orders, including resolutions on assigning inspections of the supervised entities,
- assume other authorities, which are not reserved for the Board of the CBA by law.

4. The Board of the Central Bank

The Central Bank Board is the highest governance body of the Central Bank. The Board adopts normative and individual decisions.

The Board is comprised of the Chairman of the Central Bank, his/her deputy and five members. A Board member of the CBA is responsible for carrying out duties reserved for him/her in the areas specified by the CBA Board. The CBA Board is also responsible for[1]:

- issue and revoke or annul banking and other licenses, and approve the procedure of licensing banks and other entities,
- pursuant to the law of the Republic of Armenia "On the Bankruptcy of Banks, Credit organizations, Investment Companies, and Insurance Companies" declare a bank, credit organization, or insurance company insolvent, and institute bankruptcy proceedings against them in accordance with the procedure stipulated by law,
- approve prudential requirements for banking activities and the procedure of their calculation,
- give preliminary consent to or reject the acquisition of a significant participation in a bank's statutory fund,
- define the minimum requirements of internal control in banks and insurance companies,
- approve reporting forms submitted to the Central Bank by banks and other entities licensed and supervised by the Central;

[1] *Republic of Armenia Law on the Central Bank of the Republic of Armenia.*

- approve procedures for operations with securities, coordinating them all with the authorized body of the Government of the Republic of Armenia;
- exercise authorities as set forth in law of the Republic of Armenia "On Guarantee of Reimbursement of Bank Deposits of Natural Persons".

Sessions of the Central Bank Board shall be convened upon necessity at the request of the Central Bank Chairman, Deputy Chairman, or at least three Board members, but, in any case, no less than once a month. Sessions of the Board of the CBA are minuted. The Board of the CBA is authorized to take decisions, if at least five members of the Board are present at session, including the Chairman or the Deputy Chairman of the Central Bank. A decision taken by the Board is deemed passed if more than half of the members present at the session have voted for it.

Processes of Licensing, Supervision and Regulation of Financial Institutions

Licensing of Banks and Credit organizations

Banks and credit organizations are licensed on the basis of the Central Bank-approved Regulation 1 (Registration and Licensing of Banks and Branches of Foreign Banks; Registration of Branches and Representations; Qualification and Registration of Management of Banks and Branches of Foreign Banks) and Regulation 13 (Registration and Licensing of Credit Organizations; Recording of Branches and Representations; Consenting to the Acquisition of Significant Participation in the Statutory Fund; the Qualification of Managers; the By-Laws of Credit Organizations; and Requirements on the Place of Activities and Technical Adequacy of Credit Organizations).

Bank licensing is a three-stage process.

During the first stage, preliminary consent to licensing is obtained by means of the initiators submitting to the Central Bank a request, the draft By-Laws and three-year business plan of the bank being created, and information about persons acquiring a significant participation in the statutory fund of the bank being created.

The Central Bank approves a request by the founders of a financial organization, if:

- ✓ Its founders do not have bad character and are not subject to criminal prosecution;
- ✓ Investments made in its capital have a lawful origin;
- ✓ Its executive body and managers comply with the professional qualification requirements set by the Central Bank;
- ✓ Its business plan is feasible and in conformity with the Central Bank-approved form, hence, by acting in compliance with the program, the Bank would be able to perform sound banking activities;
- ✓ The presented founding documents are credible and do not contain false information,
- ✓ Other provisions.

The second stage is the registration by the Central Bank of the bank or the foreign bank branch. At this stage, it is required to submit to the Central Bank a registration application, the by-laws of the

bank being created, a list of managers and a statement about their activities, data required by the CBA on persons acquiring significant holding in the statutory capital of the bank, and other documents as specified by the Central Bank. The Central Bank decides to register the bank, if all the required documents have been submitted and reflect credible information, and if the financial status or character of the bank's qualified shareholders and their related parties will not negatively affect the bank's financial status or obstruct effective supervision by the Central Bank or hinder identification and efficient assessment of the bank's risks.

The third stage is the obtainment of a license, for which a bank may apply within a year of receiving the Central Bank's preliminary consent. The Central Bank shall award a license to a registered bank, if a number of conditions have been met, including, among others, payment of the minimum amount of the bank's total capital, the creation of technical conditions and facilities for the bank's activities in accordance with the established criteria, internal organizational structure and operational system are in place, the qualification and professional skills of the banks' managers are in accordance with specified requirements, and the like.

The CBA issues a license and register a commercial bank or branch of foreign bank within three months, if the requirements specified by law have been fulfilled.

The licensing and registration of credit organizations is performed in one stage. To obtain a license, the founders of the credit organization being created submit to the Central Bank a registration and licensing application, the by-laws of the credit organization, a statement about the activities of managers, information about entities having a significant participation in the statutory fund (in the form and procedure specified by the Central Bank), and the rules and regulations of the credit organization.

The Central Bank licenses and registers the credit organization within a one-month period, if the statutory fund has been paid in full, the premises of the credit organization correspond to the established technical adequacy requirements, qualification and professional skills of the bank's management comply with the established requirements and the significant holders of the credit organization were approved by the Central Bank.

Licensing of Securities Market Specialized Entities

Securities market specialized entities are licensed in accordance with the Republic of Armenia Law "On Regulation of Securities Market", Regulation 4/01-[2], approved by the CBA Board in 2008, Regulation 5/01[3] and Regulation 5/02[4]. These documents stipulate that registration and licensing of a

[2] *Regulation 4/01, "Licensing and Registration of Investment Companies, Registration of Branches of Investment Companies and Foreign Investment Companies and Representations, Procedure on Preliminary Consent to Obtain Qualified Holding in Statutory Capital of Investment Companies, Procedure, Mode and Timeframe of Submission of Business Plans by Investment Companies, Provision of Advice on Investment Services Rendered by Credit Companies."*

[3] *Regulation 5/01, "Registration and Licensing of Regulated Market Operator; Procedure for Obtaining Preliminary Consent for Qualifying Holding in Statutory Capital of Regulated Market Operator ; Procedure, Mode and Timeframe for Presentation of Business Plan."*

[4] *Regulation 5/02, "Registration and Licensing of the Central Depository; Procedure for Obtaining Preliminary Consent for Qualifying Holding in Statutory Capital of the Central Depository; Procedure, Mode and Timeframe for Presentation of Business Plan."*

company (investment company, regulated market operator, the Central Depository) is performed by the single subject – i.e. the Central Bank. Registration and licensing is a one-stage process, which lasts one month. To receive the license, a company submits the following documents to CBA:

a/ information on shareholders, for verifying their compliance with the requirements of legislation in terms of not impairing regular activities of the company (such as adequate qualification, reputation and conduct);

b/ information on managers, for verifying their compliance with the requirements of legislation in terms of not impairing regular activities of the company (operator, Depository), (such as adequate qualification, reputation and conduct);

c/ business plan, for assessing the soundness of the shareholders' plans in terms of ensuring business sustainability;

d/ constituent documents of the legal person;

e/ business rules,

f/ documents verifying that statutory capital is duly paid up from lawful sources;

g/ adequacy of professional qualification of the employees rendering services;

h/ documents on facilities and technical availability.

Reforms have been implemented in the area of licensing operators of securities market; in particular, the principle of "one stop shop" licensing and registration procedure was implemented.

The professional conformity of candidates for appointed or elected management positions in organizations licensed by the Central Bank is checked by the Licensing and Supervision Committee of the Central Bank. The qualification standards for the managers of companies operating in security market and entities providing investment services were established in 2008, in accordance with regulation 4/05 "Qualification of Entities Providing Investment Services, the Operator, Managers of the Central Depository, and Natural Persons Providing Investment Services; Professional Conformity Criteria and List of Topics for Professional Qualification Testing". The qualification standards are revised and updated on an annual basis.

Licensing of Insurance Companies and Intermediaries

Insurance companies and intermediaries are licensed in accordance with Regulation 3/01[5] approved by the Central Bank Board in 2007. To the extent possible, the licensing procedure has been harmonized with the licensing procedures of other financial organizations (banks and credit organizations) and the European standards of licensing.

[5] *Regulation 3/01: "Licensing of Insurance and Insurance Brokerage Activities; Recording of Insurance Agents, Registration of Foreign Insurance Company Branches and Representations in the Republic of Armenia, Procedure of Consenting to the Acquisition of Significant Participation in the Statutory Fund of an Insurance Company, the Insurance Company Business Plan Form, Presentation Procedure, and Deadlines, the Qualification of Insurance and Insurance Brokerage Companies Managers and Officials, Professional Conformity and Qualification Criteria on Insurance Companies' Managers and Insurance Brokers' Officials, the Professional Conformity Testing and Qualification Procedure, and the List of Topics for Professional Qualification Testing of Insurance Companies Managers and Insurance Brokers' Officials".*

A "one stop shop" principle has been implemented for insurance companies: their registration and licensing is now carried out by one entity, the Central Bank. The licensing and registration procedure is implemented in one stage, which lasts a month.

The new licensing procedure assesses the conformity and intentions of the owners and managers of the entity being licensed. Three main categories of information are required for licensing:

a/ information about owners in order to check their compliance with requirements of the legislation from a standpoint of not interrupting the normal functioning of the company (proper qualification, character, and conduct);

b/ Information about managers in order to check their compliance with the requirements of the legislation from a standpoint of properly managing the company (proper qualification, character, and conduct);

c/ Business plan in order to assess the feasibility of the owners' intentions;

Licensing of Other Financial organizations by the Central Bank

The CBA also performs licensing of other financial institutions, and the processes thereto are described in detail in the following documents:

- ✓ "Procedure of Licensing Pawnshop Activities in the Republic of Armenia",
- ✓ Regulation 10: "Regulation and Licensing of Foreign Currency Purchase and Sale Operations",
- ✓ Regulation 12: "Regulation and Licensing of Foreign Currency Dealer Purchase and Sale Operations",
- ✓ Regulation 16: "Licensing of Money Transfer Organizations, Registration of Branches and Representations, Regulation of Activities, and Qualification of Managers",
- ✓ Regulation 17: "Licensing of Organizations Processing and Clearing Payment Instruments and Settlement Documents, Registration of Branches and Representations, and Qualification of Managers",
- ✓ Regulation 18: "Granting Permission to Create and Operate Armenian Payment and Settlement Systems",
- ✓ Regulation 19: "Granting Permission to Participate in Foreign Payment and Settlement Systems",
- ✓ Regulation 11: "Licensing, Regulation, and Supervision of the Organization of Foreign Currency Trading in the Republic of Armenia Territory".

Regulation and Supervision of Financial institutions

As a rule reforms of the regulation framework are result of the necessity to provide solutions to the new challenges rising in light of the new developments in the financial system. The CBA identifies system risks and challenges affecting the sustainability and development of Armenian financial system, carries out research and proposes institutional and legal solutions thereto. The CBA keeps track of the trends and developments, as well as the new technologies emerging in global financial markets, and provides respective solutions where their introduction and implementation is feasible.

The supervisory body of the CBA performs documentary (hereinafter referred as off-site) and on-site inspections of the financial institutions.

Off-site supervision is carried out on the basis of information obtained from financial organizations. The off-site supervision of each financial institution is performed by designated supervisors that are experienced in supervision of the particular organization. This enables the supervisor to develop more complete understanding of the financial organization's activities, its peculiarities, and risks.

For the purpose of off-site supervision, the supervised organizations submit to the CBA Statistical Department reports in manner prescribed by law and in compliance with provisions of the respective regulations, with the defined content and frequency. After cross-checking reports are conveyed to the Financial Supervision Department and Financial System Policy and Analysis Department. To improve the efficiency of supervision and analysis activities, these departments also use information received from the Credit Registry, earlier reports submitted to the Central Bank, notes received during the current and previous periods, notifications, long-term development plans, published financial reports, supervisor opinions annexed thereto, the results of inspections in supervised organizations, and information obtained in other ways.

The main objective of the off-site supervision of banks is to identify and assess the risks through carrying out weekly, monthly, quarterly and annual analysis to prevent or reduce possible losses of the banks. One supervisor can simultaneously supervise not more than three banks, and each bank must be monitored by at least two supervisors. The off-site supervision of banks is carried out pursuant to the rules of the manual "On Off-Site Supervision", which defines principles and methods of the off-site supervision, its sequence and frequency, as well as the list of persons engaged and their rights and responsibilities.

Based on the analysis of information obtained from banks, internal briefs are compiled for each bank, describing major changes in the bank's performance indicators, the main trends in its performance, an assessment of the bank's current financial situation and outlook, the issues faced by the bank, and risk areas. Off-site supervision reveals not only changes in a bank's financial performance indicators, such as deviations from the regulatory requirements set by the Central Bank, but also their causes and changes are analyzed, based on which an appropriate action plan is devised to manage identified excessive risks.

The main purpose of the weekly off-site supervision is to operatively monitor banks' daily operations. The main directions of the weekly off-site inspections is to check compliance of a bank's activity with the Armenian laws and other regulations, analyze its balance and off-balance structure, risk areas and problematic changes. During the analysis, supervisors identify areas of banks' performance which, given the existing situation, are most volatile and vulnerable to risks, or which resulted in generation of the problems during the previous reporting period.

The main purpose of monthly off-site supervision is to assess and analyze the bank's activities and actual current financial status during the month. Consolidated assessment of bank's activities is performed, and the respective analysis is carried out. It involves assessment and analysis of the

quality of banking assets, capital adequacy, profitability, liquidity, sensitivity to market risks, management quality, and performance of the managers. The analysis of information in the context of monthly supervision must have a clear regulatory focus, i.e. the supervisor must develop and recommend ways of addressing the significant problems identified, mitigating their impact, or preventing their re-emergence. If CAMELS assessments deviate sharply in comparison with a previous period, the supervisor conducts a thorough analysis to discover the reasons[6].

The main purpose of quarterly off-site supervision is to assess and analyze the banks' current financial situation and outlook, as well as risks. Quarterly off-site supervision must focus on assessing the banks' ability to operate sustainably, including an assessment and analysis of the banks' activities, changes in the banks' financial situation, risks typical of the bank, and financial stability. In the frameworks of quarterly off-site supervision, the supervisor must assess and analyze risks, including the credit risk, liquidity risk, interest rate risk, foreign exchange risk, price risk, operational risk, and reputation risk.

Furthermore, examinations of information published by financial institutions are performed on a quarterly basis, in order to identify how the organizations present data subject to disclosure for consumers.

Off-site supervision encompasses the analysis of a banks' credit, foreign exchange, interest rate, price, and liquidity risks using the credit risk migration matrix, VAR, duration, and GAP methodologies, as well as stress tests. While analyzing the trends of such risks, growing, stable and decreasing scenarios should be applied.

The purpose of the annual off-site supervision is to analyze financial performance and sustainability of the banks during the year, in order to evaluate banks' capabilities for long-term operation.

If risks are identified in the analyses, the supervisor recommends, as needed, a list of supervision measures to ensure the banks' solvency, financial stability, and long-term sustainability of operations. Problems identified in off-site supervision may serve as a basis for on-site inspections or may be included in the comprehensive inspection plans. The off-site supervision is important since timely and accurate identification of problems and risks threatening the bank allow increases the overall efficiency of supervision, due to the effective use of supervision resources and planning of inspections in the supervised organizations.

The off-site supervision of credit organizations, pawnshops, and foreign exchange offices is carried out in accordance with the logic of the off-site supervision of banks. Their off-site supervision is implemented on the basis of reports submitted by them to the Central Bank.

Off-site supervision of insurance companies and insurance brokerage companies is performed in accordance with the "Manual on Off-Site Supervision of Insurance Companies and Insurance Brokerage Companies".

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[6] CAMELS assessment scores vary between 1-5 unit range, and in case if the score is below 3, this may stipulate the Central Bank to apply extremely tight prudential standards or sanctions, as well as impose restrictions on implementation of some transactions. In, case if the consolidated assessment score for the bank is below 2, the bank is considered insolvent.

Reports submitted to the Central Bank by insurance companies undergo the same off-site supervision and analysis process as banks. However, the analysis scope and instruments for off-site supervision of insurance companies remain very limited.

Off-site and on-site supervision of securities market participants (investment companies, the Armenian Central Depository, and the Armenian Stock Exchange is performed in accordance with the Guidelines for Inspections and Off-Site Supervision Procedure of Securities Market Professional Participants, Self-Regulating Organizations, and Issuers. Due to the reforms implemented in the area of securities market, this guideline has now become obsolete. It is planned to develop new manuals "Off-site Supervision of the Investment Companies" and "On-Site Inspections of the Investment Companies". The off-site supervision of these organizations are performed based on the analysis of financial statements submitted by the professional participants of securities market to the Central Bank.

In general terms, off-site supervision is the continuous analysis of the performance of financial organizations, including their financial status, level of risks, and compliance with laws and other legal acts regulating their activities.

To supervise compliance with rules of market conduct, special attention is paid to the information published by banks, credit organizations, and insurance companies. Their websites and reports published in newspapers are regularly studied.

In order to conduct a more thorough review of risks identified during off-site supervision and their causes, on-site inspections of organizations are carried out. On-site inspections are also carried out on the basis of the banks' and other financial organizations' inspection timetable approved by an instruction of the Central Bank Chairman.

The Central Bank conducts on-site inspections of banks and foreign bank branches operating in Armenia in accordance with the Bank Inspection Manual. When supervising different areas of a banks' activities, supervisors assess the applicability of the banks' internal control system, processes, internal policies regulating the respective areas, and procedures. They assess the banks' internal control system and the effectiveness of internal audit to determine whether the banks' employees are complying with the principles set by the banks' management. Special attention is paid to analyzing the banks' management system and identifying the related risks, including, in particular, the separation of rights and responsibility between the banks' board and executive management.

There is a particular focus on identifying the areas of the banks' activities, which are the most vulnerable and sensitive to risks. Those areas must be supervised rigorously.

The on-site inspection should focus on the following issues:

- Asset Quality

  The purpose is to identify the structure of the banks' assets with a focus on assessing loan portfolio quality and level of management. Lending activities must be carried out in accordance with policies and procedures approved by the bank, and exceptions from them must be properly

justified and documented. During the inspection special attention is paid to quality, profitability, loan return rate and provision rate for loan losses of the loan portfolio.

- Liabilities and equity

  The purpose is to identify the structure of the bank's liabilities, especially deposits, concentrations, and the conformity of the funding process with the bank's policies and procedures. While examining the bank's borrowings, supervisor should focus on the compulsory reserve ratio and excessive liquidity level, as well as identify reasons, sources, average volume and maturities thereto, costs of the borrowed resources and the efficiency of their use. During the inspection, the adequacy of the bank's capital with its financial situation, risks, and volumes of operations is assessed.

- Profitability

  The analysis of incomes and expenses allows the supervisor to form an opinion of the bank's financial situation and the results of its operations, as well as to determine the credibility of data reflected in the banks' income and expense accounts. During the inspection, the supervisor should assess the level and the trends of profit, its elements and their stability, probability of bank's operation without losses and compliance with the capital adequacy prudential, compliance with the prudential on the minimum size of the total capital, planning of expenses and income, and the involvement of the management in planning expenses and income.

- Liquidity

  During the inspection, the supervisor should assess current liquidity of the bank, liquidity demand, current and expected cash flows, sources for the attraction of resources and their cost. The supervisor checks whether the bank has a plan to meet extraordinary liquidity needs, which may become necessary in case of income deterioration, higher non-performing assets, deposit concentration, unforeseen opportunities to expand operations, and other events.

- Management

  The supervisor assesses the quality of the banks' corporate governance, the duties and responsibility of the banks' executive managers, and the risk management system. The purpose is to discover to what extent the banks' corporate governance mechanism works to the benefit of shareholders and other stakeholders. As a priority, the management structure and processes are assessed. The purpose of assessing the quality of the banks corporative management is to identify the efficiency of cooperation between the bank board, executive directors (directorate), shareholders and other interested parties. During the assessment of the risk management system, the supervisor should identify the strategies of risk identification, measurement, assessment, monitoring and management.

- Combating legalization of illegal proceeds (money laundering) and terrorism financing

  While examining this issue, the supervisor identifies whether the respective policies, procedures and internal control are adequate for the efficient management of such risks. The supervisor should verify the compliance of the implemented measures with the policy adopted

by the bank, availability of the internal regulations on identification of suspicious transactions and regulations establishing norms and provisions for filing the respective reports to the authorized body in the Central Bank, etc.

- Supervision of market conduct

  While examining this area, the supervisor should identify the possible inconsistencies and risks in terms of the business conduct of a bank, which can pose a threat to the interests of the consumers of financial services. This area includes adequate presentation of information published by the bank, rendering consultations to customers, processes of complaint and dispute resolutions, dissemination of information on rendered services, and servicing of the customers.

- Other areas

  The quality of market risks management, the quality of operational risk management, bank-related parties, computer and information systems, legal issues, off-balance sheet operations, internal audit and internal control, checking the credibility of reports submitted to the Central Bank, payment system risks, and electronic transfer of funds.

- General assessment of the bank

  As a result of the general assessment of the bank, the supervisor obtains the picture of the bank's internal financial performance and perspectives, taking into account such factors as the system of the bank's internal control, the availability of internal policies and procedures, infringements of the laws and/or other regulations, the quality of the bank managers, the adequacy of banking capital, the volume of classified assets, the availability of the major parameters describing activities of the bank, etc.

Based on the results of the inspections, supervisors should prepare the inspection reports, which should reflect the major directions and the framework of the performed inspections, identified problems and risks, bank's financial performance, compliance with prudential standards, consolidated assessment of the bank's indicators (CAMELS), as well as submit opinions and the respective suggestions on the performed inspections.

The on-site inspections of the organizations rendering insurance services should be performed in accordance with the manual "On the (on-site inspections) of the organizations rendering insurance services within the Republic of Armenia". The on-site inspections involve the following directions: insurance (underwriting), asset quality, capital and yield, governance, reinsurance, realization of the insurance products, other areas (protection of the insured persons, compliance with the rules of market behavior, computer and informational technologies, legal issues, verification of the consistency of the statements filed with the Central Bank). While performing inspections of the different areas of the insurance companies' activities, supervisors should assess the system of internal control of the insurance company, and application of the internal policies, procedures and regulations regulating the performed operations and the activities carried out in these areas. Furthermore, supervisors should assess the system of the internal control of the insurance company.

The on-site inspections of insurance market participants are performed in accordance with the guideline "Procedures on inspection and off-site examination of persons carrying out professional activities in securities market". The on-site inspections of insurance market participants involve the following directions: verification of the compliance of the market participant's activities with the laws and other legal statutes regulating professional activities of the market participants within the framework of the respective license, checking the consistency of data included in the statements and other information disclosed by the market participants (irrespective of the information carrier), analysis of the market participant's financial performance, examination of the process and results of fulfilling instructions and suggestions provided to a market participant by the CBA and on-site inspection of the compliance of other activities carried out by market participant (excluding professional activities in securities market) with the requirements of the regulating laws and by-laws.

The inspection of persons propounding public offerings of securities and the reporting issuers should be performed with the view to verifying the compliance of their activities with the provisions of law.

The on-site inspections in pawn houses and exchange offices should be performed with the view to verifying the compliance of their activities with the provisions of law.

The inspection program must be approved by the CBA Licensing and Supervision Department. At the end of each inspection, the group of supervisors must compile the inspection report and submit it to the CBA Board.

CHANGES IN FINANCIAL SYSTEM REGULATORY FRAMEWORK IN 2008

Given the on-going developments in the real and financial sectors of economy, it is necessary to constantly strengthen the financial system regulatory framework. In 2008, the CBA continued the process of implementing a number of legislative reforms relating to the activities of the Armenian financial system.

Changes in the financial system regulatory framework

Legislative changes

1. In 2008, the National Assembly of Armenia endorsed amendments and addenda to the laws **"On Guarantee of Remuneration of Bank Deposits of Individuals"** and **"On Bankruptcy of Banks, Credit organizations and Insurance Companies"**, designed by the CBA. The purpose of the amendments was to streamline the existing regulation, as well as bring it into compliance with certain requirements of the European Union legislation. The first law stipulates that in case if the cash balance on the accounts is less than 1,000 Armenian drams, they should not be guaranteed, sets forth the condition of creating informational electronic system on the guaranteed bank deposits and depositors, streamlines articles relating to organization of the process of deposit remuneration, sets forth a liability for the Fund to pay deposit indemnity within the next three months after receiving verified claims from the individual depositors, and stipulates indemnity of the expenses incurred by the Fund. Furthermore, the law stipulates guaranteeing of the deposits attracted in the branches of the foreign banks established within the Republic of Armenia.

2. In 2008, the National Assembly of Armenia also endorsed the law **"On Amendments and Addenda to the Law "On Credit organizations"**. This law was endorsed due to a number of reasons:

2.1. Allow credit organizations to receive a banking license with a possibility to change the type of activities, or change the type of the credit organization, define peculiarities of this process and introduce the relevant mechanisms.

2.2. Envisage the possibility of attracting borrowings by credit organizations through placement of issued bonds among households.

3. In 2008, the National Assembly also endorsed a package of laws enhancing development of the secondary securities market and mortgage securities market, in particular the laws **"On Covered Mortgage Bonds" and "On Asset Securitization and Asset Backed Securities"**.

3.1. Pursuant to the "Covered Mortgage Bonds Law", the covered mortgage bonds should be issued:

1. by banks and credit organizations,
2. on the basis of the mortgage loan portfolio (the assets are mortgage loans solely),
3. mortgage loans remain in the balance sheet of a bank, or credit organization.

The law establishes criteria for such assets, which will serve as a coverage resource for covered mortgage bonds. Thus, for example, coverage resources for covered mortgage bonds should exceed the liabilities on covered mortgage bonds.

Furthermore, the law envisages creation of a new mechanism of Controller, whose main responsibility should be maintaining the roster of the issuer's coverage resources, as well as imposing control over adequacy of coverage resources and mortgage bond liabilities.

In addition, the law envisages creation of the roster of covered mortgage bonds. In case of bankruptcy or insolvency of the issuer, assets included in the roster should be separated from other assets of the issuer and not counted during bankruptcy proceedings. In case of bankruptcy, a Mortgage Administrator should be appointed, whose main responsibility should be to manage assets, which serve as a coverage resource for covered mortgage bonds and meet the claims of the investors in covered mortgage bonds.

3.2. According to the Armenian law "On Asset Securitization and Asset Backed Securities", the issuer of asset backed securities:

1. is a mediator of special importance (of a non-commercial fund), who is dealing solely with securitization,
2. has only a board of directors, while current activities are managed by the managed of Securitization Fund, which is a commercial organization,
3. benefits from the tax privileges, such as VAT exemption against transactions on alienation of Securitization Fund assets.

Subject to securitization are not only mortgage loans, but also financial assets, which ensure certain cash flows. Assets are sold to the Securitization Fund, i.e. they are excluded from the balance sheet of the generating bank or credit organization and included in the balance sheet of the Securitization Fund.

4. In 2008, the Armenian National Assembly reviewed and endorsed a legislative package with the view to protecting interests of the financial system consumers. This package includes the laws "**On Attraction of Banking Deposits**", "**On Consumer Credits**" and "**On Financial System Conciliator**".

4.1. The purpose of the law "On Attraction of Banking Deposits: is to establish unilateral procedures and conditions for attraction of household deposits by banks and ensure protection of consumer rights through these procedures. The law establishes provisions concerning advertisement of banking deposits and accounts, as well as defines information, which should be disclosed to consumers prior to signing a banking deposit, or a banking

account agreement. Such information includes the amount of interest rates, frequency of their capitalization and payment, the minimum balance of account, as well as various fees and penalties. Furthermore, the law regulates relations pertaining to communication issues, in particular, procedure and frequency of providing account statements.

4.2. The purpose of the law "On Consumer Credits" is to protect the rights of consumers in the financial sector, establish unilateral crediting rules, enhance financial mediation and increase consumer confidence towards financial system. The law defines scope of information to be disclosed to the consumers prior to signing credit agreements. Consumers should be informed about all expenses associated with the credit, including interest rates, servicing fees and all other compulsory payments. The law establishes additional rights for the consumers, such as the right of the early credit repayment (call provision). Pursuant to law, in case of an early repayment, the consumer is not obliged to pay any penalty, or indemnity. Furthermore, the person who has repaid the credit ahead of the schedule may request a proportional reduction of his expenses associated with the credit. The law defines cases when the consumer has the right to direct immediately to the financial institution claims on deficiencies of the purchased goods or services. Persons selling goods or rendering services may receive license for providing consumer credits and independently extend credits to consumers, thus enhancing competition in the financial sector.

4.3. The purpose of the law **"On Financial System Conciliator"** is to protect rights and interests of financial sector consumers, provide quick, efficient and fee free examination of their claims, increase public confidence towards financial system and enhance financial mediation. The financial system conciliator examines actions brought by household customers against financial institutions, relating to services provided by organization and presenting a cash or property claim not exceeding ten million Armenian drams. Financial system conciliator does not charge fee from customer by for examining a claim and taking decision thereof. Financial system conciliator should solve a dispute within a possibly short period, which in any case should not exceed two months. The decision of the conciliator becomes mandatory for the parties only if the customer agrees with it. Financing of the financial system conciliator's office should be provided by all the financial institutions in the form of fee prescribed by law.

5. The Armenia National Assembly has also endorsed the law **"On Dissemination of Credit Information and Activities of Credit Bureaus"**, designed by the Central Bank, as well as laws on amendments in a number of other laws resulting from this law.

The law stipulates creation of a new institution in the Republic of Armenia, which pursues the following objectives:

a. increase the scope of financial intermediation and lending activities in the Republic of Armenia financial market;
b. create additional mechanisms for the protection of consumer interests in financial market;

c. create mechanisms of the risk assessment by financial institutions and protect interests of the borrowers,
d. introduce and develop a rating system in the Republic of Armenia,
e. create a possibility for the consumers to borrow large credits by presenting their credit histories,

The law was developed based on the best international practices and was passed the US AID expertise.

In terms of consumer right protection, the Law prescribes:

a. ensure affordability of services rendered by credit bureaus to consumers, such as fee-free provision of the credit report by a credit bureau to a consumer once in a year, as well as a fee-free provision of the credit reports in case of negative implications for the consumer (for example, if the bank refuses to extend a loan, because of the borrower's bad credit);
b. a comprehensive regulation of procedures on up-dating, litigation, or revision of credit information, as a result of which the consumer is entitled to be fully informed on all the relevant data, and correct inconsistencies in information, if they are identified;.
c. ensure transparency of the credit bureau operations (availability of the credit bureau web page, where the bureau should place and update information on the rendered services, dispute solution procedures and the received credit reports);
d. Licensing and supervision of the credit bureau operations. The law defines certain procedures in terms of the operations performed by credit bureaus, and supervision of these operations with the view to protecting consumer rights.

6. The Armenian National Assembly also endorsed the law **"On Combating Money Laundering and Terrorism Financing",** which necessitated making a number of changes in the banking laws. The amendments and addenda proposed by the laws pursue the following main objectives:

a. Expand the list of reporting persons.
   The scope of non-financial institutions and persons included in the list of reporting persons was brought into compliance with the respective Financial Action Task Force (FATF) standards.
b. Provide mechanisms for identification of the real beneficiary of a transaction;
c. Introduce the concept of a "person exerting political influence" and procedure on monitoring of transactions involving such persons,
d. Streamline and expand criteria of conspicuous transactions;
e. Introduce the requirement for the additional declaration of transactions (business relations);
f. Establish new streamlined procedures on cooperation between the authorized body and other state agencies, as well as on international cooperation;
g. Introduce basic provisions on regulations to be developed by the authorized bodies and the internal regulations of the reporting persons;
h. Establish responsibilities relating to non-cash transfers;

i. Ensure protection of the authorized body, reporting persons and their employees during execution of their responsibilities prescribed by law;
j. Provide a clear definition of the liabilities and functions of the authorized body;
ja. Define the cases when the mandatory identification of the customer is required, as well as the basic requirements in terms of identification and personality verification data;
jb. Establish the procedure for identification of the business stance of the customer and current monitoring of his business relations;
jc. Define functions of the internal observation (intelligence) unit of the reporting persons;
jd. Revise and update procedures on suspension and waiver of business relations or transactions;
je. Envisage provisions on freezing financial resources of persons involved in terrorism;
jf. Amend the disposition of crime components in terrorism financing:

Pursuant to the FATF special standard No2, the concept of terrorism financing should be extended on persons who deliberately allocate or mobilize resources, directly or indirectly, with a criminal intent of the full or partial use of the resources for:

a. performing terrorist activity (activities),
f. by terrorist organization,
c. by an individual terrorist.

The proposed change in the criminal content disposition is included in Article 217.1 of the Republic of Armenia Criminal Code;

jg. Establish procedures of control over the fulfillment of the provisions set forth by law;
jh. Define by law the most efficient mechanisms for the enforcement of the responsibility measures.

7. In 2008, the Armenian National Assembly endorsed the law "**On Amendments and Addenda to the Republic of Armenia Law on Accounting**", designed by the CBA. The law establishes that the banks, credit organizations, clearing companies, reporting issuers in securities market, persons rendering investment services, operator of the regulated market, the Central Depository, insurance and re-insurance companies, and insurance brokers are obliged to prepare financial statements and submit them for accounting in accordance with the international standards and without their direct translation by the Republic of Armenia, while other organizations must implement the international standards in compliance with the procedure prescribed by the Republic of Armenia Government starting from January 1 of the next year, after six months from promulgation.

8. The Armenian National Assembly endorsed the law **"On the All-Armenian Bank",** which necessitated making a number of amendments and addenda in the respective laws.

The purpose of adopting this law is to establish legislative grounds for creation of the All-Armenian Bank and its business operations.

The law establishes the goal of the bank, the main principles of activities, procedure for the formation of the managing bodies, etc. The goal of creating the All-Armenian bank is to foster

formation of a strong, competitive and knowledge-based potential, and its utilization for increasing competitiveness of all Armenian people in the global market.

Upon receiving a banking license, the newly-created organization will perform as a bank and carry out operations, which are specific for a bank, excluding attraction of funds from residents through public offerings.

Activities of the All-Armenian bank will be regulated by the laws and by-laws, which regulate the banking system activities, unless otherwise prescribed by the law, and will be monitored by the CBA.

The All-Armenian bank will operate in accordance with definite principles, such as not competing with the banks, furthermore, in designing the program of activities it will be guided by the strategy of the body authorized by the Armenian Government.

In 2008, the CBA developed and revised a number of regulations relating to banking activities, as follows:

- Within the framework of the measures implemented in the area of regulation and supervision of banking activities, amendments were introduced to Regulation No2 "Regulation of Banking; Main Prudential Standards for Banking" according to which, while calculating the standards S^3 and S^4, the "Risk" components did not include claims with high level of coverage, such as securities issued by the CBA, government treasury bills, securities issued by international organizations and foreign states with high ranking, and claims covered with guarantees and letters of guarantee.

In the context of credit risk mitigation procedures used in calculation of the capital adequacy standard (hereinafter the CRMT), it was decided that a claim covered with a guarantee or a letter of guarantee should be counted in calculation of credit risk at a zero percent risk weight, if the guarantee or the letter of guarantee is provided by the Republic of Armenia Government or the Central Bank.

With the view to increasing efficiency of liquidity management by the banks, the period for adjustment of mandatory reservation was established as 28, or 35 days, in accordance with the time-table established by the CBA Board for reservation requirements, to stay in line with the seasonality features of the state budget and the economic entities. Subsequently, the level of liquidity management will improve and the volume of excessive liquidity within correspondent accounts will decrease.

The long-term subordinated borrowings attracted as a new instrument for total paid up capital were included into the additional capital. At the same time, the definition of subordinated borrowings was streamlined.

- The CBA Board took approved Regulation No3 "Banks' Statements; Submission and Publication of Banks' Statements", which is aimed at:
  - Ensuring consistency of the reports submitted to the CBA with the changes in the normative framework;
  - Ensuring a unified database, with the view to increasing the efficiency of data processing works.

The guideline on the reporting forms submitted to the CBA by the commercial banks was updated, and brought into compliance with the provisions of Regulation No2 "Regulation of Banking; Main Prudential Standards for Banking", which entered into force on January 1, 2008. The new guideline was incorporated into regulation No3, in order to make it more clear and useful for the banks.

In light of the legislative provisions on protection of customer and consumer interests, the regulation No3 stipulated that the banks must calculate and disclose effective interest rates on resources attracted from the real sector and the allocated resources.

- Within the statements submitted to the Central Bank, funds available on demand must be included as balance amounts as of the day of reporting on assets and liabilities, furthermore their interest rates are calculated by using the annualized agreed rate, (AAR) formula.
- For calculation of interest rate on term funds, the narrowly defined effective rate, (NDER) formula is applied.

Form No 17 indicates the actual annual interest rates on allocated resources. This interest rate is calculated by the same formula and methodology as NDER, however it incorporates not only total interest, but also all repayments, which the borrower should make against the received loan.

- With the view to maximizing uniformity of the procedures on licensing and registration of the financial market participants, registration of branches, acquisition of qualified holding within the company, award of qualification and registration of company managers, amendments were introduced into regulations on registration and licensing of the banks, credit organizations, insurance companies, investment companies, regulated market operator, and the Central Depository.
- According to the Republic of Armenia law of March 18, 2008 "Law on Introducing Amendments and Addenda to the Law On Guarantee of Remuneration of Bank Deposits of Natural Persons", the CBA Board approved the procedure on "Electronic Data Processing and Data Saving System for Information Provided by Banks on Deposits and Depositors". The procedure is aimed at increasing the efficiency of organization of deposit indemnity process and protection of depositor interests.
- The CBA Board endorsed under a new edition the bulletin "Basic Conditions of Internal Banking Control", with the view to increasing the efficiency of risk management and organization of business by banks, as well as ensuring consistency and integrity of accounting, financial and other statements, which are necessary for taking decision on the bank.

Starting from 2008, the CBA publishes on the web site the questions of the examinations for testing the quality and professional capacity of candidates for senior positions in the commercial banks.

The major by-laws designed and amended by the CBA in 2008, with the view to regulating the insurance market:

- Regulation No 3/09 "Regulation on Classification of Assets of Insurance Companies; Formation and Use of Loan Loss Provisioning" (approved by the CBA decision No 73-N of 25.03.2008), for

ensuring acquisition and reflection of consistent information on total capital and assets in the statements of insurance companies, used for calculation of the main prudential standards based on reliable data about the value of assets.

- Regulation No 3/02 "Procedure on the Size, Formation and Calculation of the Main Prudential Standards of Insurance Companies" (approved by the CBA decision No 311-N of 02.10.2007). With the view to ensuring sound operation and financial sustainability of insurance companies, the floor on total capital was raised. For insurance companies which are established after January 1, 2009, and for those operating as of January 1, 2010, the floor on total capital is 1-1.5 billion drams, depending on the class of insurance operations, which an insurance company can perform. The procedure for calculation of insurance risk for single case, aimed at reducing the level of concentration of insurance risk within insurance portfolio, was amended. The standard on risk for single borrower was introduced, with the view to reducing the level of risk concentration for single borrower and parties related to him within the assets of the insurance company.
- Regulation No 3/04 "Procedure and Periods of Filing Reporting Forms by Insurance Companies; Information to be Included in the Forms" (approved by the CBA decision No 366-N of 16.11.2007). The purpose of the amendments is to ensure disclosure by insurance companies of all information necessary for performing the off-site inspections".
- Amendments were introduced to Regulation No 3/01 "Licensing of Insurance Activities and Insurance Intermediary Activities; Accounting of Insurance Agents; Registration of Branches and Representations of Foreign Insurance Companies operating in the Republic of Armenia; Obtaining Preliminary Consent to Qualifying Holding in Statutory Capital of Insurance Company; Insurance Company's Business Plan Disclosure, Procedure and Date; Testing of Qualification of Candidates for Officials and Responsible Persons of Insurance Company and Insurance Intermediary; Professional Competency and Qualification Criteria Officials and Responsible Persons of Insurance Company and Insurance Intermediary; Themes of Qualification Test for Officials of Insurance Company and Responsible Persons of Insurance Intermediary", (approved by the CBA Board by decision No 344-N, of 30.10.2007), with the view to maximizing compatibility of procedures on licensing and registration of the financial market participants (insurance companies, persons rendering insurance intermediation services, banks, investment companies, operator of regulated market, the Central Depository), acquisition of qualified holding, qualification award and registration of the senior officials.
- "Plan of Accounts of Insurance Companies" and "Instruction on Implementation of the Plan of Accounts by Insurance Companies" (approved by the CBA Board by decision No 314-N, of 02.10.2007). The new amendment is aimed at increasing the scope of instructions concerning the plan of accounts and its implementation, in order to present in more detailed form information on the most significant transactions carried out by insurance companies.
- The list of themes of qualification test for officials of insurance companies and responsible persons of insurance intermediary companies was revised and brought into compliance with changes in the legislative framework.

In 2008, the CBA designed and revised a number of normative and legal statutes in the sphere of securities market regulation.

- The CBA enacted Regulation No4/01 "Licensing and Registration of Investment Companies, Registration of Branches of Investment Companies and Foreign Investment Companies and Representations, Procedure on Preliminary Consent to Obtain Qualified Holding in Statutory Capital of Investment Companies, Procedure, Mode and Timeframe of Submission of Business Plans by Investment Companies, Provision of Advice on Investment Services Rendered by Credit Companies", with the view to establishing a clear procedure for registration and licensing of investment companies, and bringing regulating activities of the banks and insurance companies into compliance with the legal statutes.
- Regulation No 402 "Main Prudential Standards of Investment Companies; Floors and Ceilings; Accounting Procedure; Components Included in the Calculation; Infringements of Prudential Standards". This regulation establishes floors on authorized capital and total capital for investment companies, as well as procedure for calculation of total regulatory capital.
- Regulation 4/04 "Prospectus and Statements of Reporting Issuers", which, given the operational urgency and problems identified during inspections, defines the contents of information subject to disclosure on derivative securities and securities converted into shares and streamlines contents of information affecting decisions of the investors. The amendments introduced by the Regulation, are necessitated by implementation of measures introduced in the survey "Capital Market Survey and Design", prepared by "NASDAQ-OMX".
- Regulation No4/05 "Testing of Qualification of Persons Rendering Investment Services, Operator, the Central Depository Managers and Natural Persons Rendering Investment Services; Themes of Qualification and Professional Capacity Tests". The purpose of this regulation is to set forth basic requirements for qualification of managers of legal persons carrying out activities in securities market and natural persons rendering services in market, in line with provisions of the national legislation and the Eurodirective criteria, as well as to bring this process into full compliance with the legal norms regulating activities of the banks and insurance companies.
- The CBA Board approved Regulation No4/06 ""Criteria for Certifying Investors as Qualified Investors and Procedure on Registration of Persons as Qualified Investors", which establishes criteria for separating qualified investors from other investors and procedure of their registration by the Central Bank, with the view to developing statutory framework for the qualified investors' institution in line with the European model,
- Regulation No5/01 " Registration and Licensing of Regulated Market Operator; Procedure for Obtaining Preliminary Consent for Qualifying Holding in Authorized Capital of Regulated Market Operator; Procedure, Mode and Timeframe for Presentation of Business Plan", which established the statutory framework in accordance with the requirements of the law "On Securities Market", is a integrated procedure for registration and licensing of regulated operator. Due to its introduction,

the new streamlined procedure for registration and licensing of regulated operators was brought into general compliance with the legal acts regulating activities of the banks and insurance companies.

- The CBA Board approved Regulation No 5/02 "Registration and Licensing of the Central Depository; Procedure for Obtaining Preliminary Consent for Qualifying Holding in Authorized Capital of the Central Depository; Procedure, Mode and Timeframe for Presentation of Business Plan", with the view to streamlining the Central Depository registration and licensing procedures and bringing them into compliance with procedures on registration and licensing of banks and insurance companies,
- The CBA introduced amendments to the Board decision No 114-N of March 25, 2003 "On Approval of the Guideline for Obtaining Qualified Holding in a Bank, Obtaining Other Holding or Performing as a Manager, Obtaining Qualified Holding in an Insurance Company, Performing as a Manager of an Insurance Company or a Responsible Person in an Insurance Broker Company", in order to extend its application on investment companies.
- The CBA Board approved Regulation No 4/07 ""Requirements on Activities of Persons Rendering Investment Services", with the view to ensuring sustainable rendering of investment services in securities market and protecting interests of the customers,
- The CBA Board approved Regulation No 4/08 "Procedure on Public Disclosure of Reports, References, Explanatory Notes and Other Documents Filed with the CBA for Off-Site Supervision and Exceptions from the Requirement of Public Disclosure", with the view to enabling consumers to obtain crucial and consistent information on financial performance and sustainability of supervised persons from single source and enhancing analysis of the essential information.
- The CBA Board approved Regulation No 5/05 " Regulated Market Operator's Reporting to the Central Bank on Violations Committed by Regulated Market Participants and Reporting Issuers ", with the view to ensuring mechanisms of cooperation between the Operators and the CBA in market supervision.
- The CBA Board approved Regulations No 5/03 and 5/04 "Procedure, Mode and Timeframe of Disclosure of Information to the CBA by the Regulated Market Operator" and "Procedure, Mode and Timeframe of Disclosure of Information to the CBA by the Central Depository", with the view to setting forth provisions on information to be disclosed to the CBA by the regulated market operator and the Central Depository, These regulations define the types of statements for submission to the CBA by the Operator and information to be included therein, to ensure sufficiency of the received information on the performance of the operators and the Central Depository.
- The CBA approved procedure "Procedure, Mode and Timeframe of Dissemination of Information by Investment Companies Through Web Sites, Press or Other Mass Media Outlets." The main objective of this procedure is to make streamline information available to consumers of investment services (investors, customers) and investment companies, through publication of information about investment companies.

Major changes in the regulatory framework of financial system participants are as follows:

- Amendments and addenda to Regulation 14 "Regulation of Activities of Credit organizations; Prudential Standards for Activities of Credit organizations" were necessitated by the changes in the legislative framework regulating activities of credit organizations and permitting credit organizations (excluding credit unions and saving associations) to render investment services. In addition, prudential standards for credit organizations were brought into an overall compliance with the banking regulatory framework.

The following amendments were made in the risk weights of the components included into calculation of credit organization assets weighted against risk:

- 0 percent risk weight on the government treasury bills;
- floors were established for mortgage loans warranting 50 percent risk weight and 50 percent risk weight on the loans satisfying these criteria;
- 75 percent risk weight on claims on retail trade and conditions for qualifying a retail trade claim were defined;
- 50 percent risk weight on items included into the category "Other claims (including accounts frozen) on Armenian banks, credit organizations and foreign bank subsidiaries operating in Armenia, and on interest accrued thereto".

Consumer Interest Protection

The CBA Board approved Regulation 8/01 "Explanations and Examples for Calculation of the Annual Actual Interest Rate". In 2008, the CBA Board approved a new by-law, ensuing from the law "On Consumer Crediting". Pursuant to law, any credit agreement between creditors (bank, foreign bank branch, credit organization, pawn shop) and consumers must contain a reference on the amount of the annual actual interest rate, furthermore, where information on the annual actual interest rate can not be effectively provided to consumers, a calculation example must be provided. Regulation 8/01 defines rules for the unified and comprehensive calculation of the annual actual interest rate by creditors.

SUPERVISION IN 2008

The CBA performs an on-going supervision of the activities of the financial system participants with the view to promoting the development of the financial system, as well as identifying and preventing excessive risks of the financial system participants. Subsequently, the CBA Department of Financial Supervision performs off-site and on-site inspections of the financial institutions.

In 2008, the CBA Financial Supervision Department performed 243 on-site inspections in commercial banks, of which 7 were comprehensive inspections, 10 specific inspections in banks, 5 inspections of credit organizations, 4 inspections of insurance companies, 24 inspections of pawn shops, 191 inspections of exchange offices, and 2 inspections of the other financial system participants.

Table1. On-Site Inspections and Workload of the Supervisors

	2006	2007	2008
Number of Supervisors in the Financial Supervision Department	49	74	74
Total assets of commercial banks, credit organizations, insurance companies, securities market participants and pawn shops (yearly average)	500.2 billion drams	674.5 billion drams	964.3 billion drams
Average workload per supervisor of the Financial Supervision Department	10.2 billion drams	9.1 billion drams	13.0 billion drams
Number of inspections performed during the year, including:	587	511	243
Comprehensive banking inspections	8	5	7
Specific inspections in banks	5	40	10
Credit organizations	4	5	5
Insurance companies	15	8	4
Pawn shops	26	30	24
Insurance market participants	5	18	1
Exchange offices	529	403	191
Other participants of financial market	-	2	1

Compared to previous years, there was a significant reduction of Infringements and violations identified during on-site and off-site inspections performed by the CBA Financial Supervision Department in 2008, mainly due to the fewer infringements relating to legislative issues, data inconsistency and accounting problems.

In 2008, the number of penalties and warnings imposed on organizations and their managers, as well as the amount of fines collected against such violations decreased as well.

Table 2. Infringements of financial institutions and penalties in 2008

	Commer-cial banks	Credit organizations	Insurance companies	Pawn shops	Clearing Companies
Area of Violation					
Accounting	10	20	12	-	-
Asset classification norms	-	3	1	-	-
Legislation	85	73	20	57	-
Prudential standards	5	1	2	-	-
Incompliance with instructions	7	-	-	-	2
Reporting delays	10	5	4	4	-
Inconsistent data	65	9	129	16	-
Total capital	-	1	-	-	-
Credit register	10	11			
Penalties					
Revocation of License	-	-	-	1	-
Fines imposed on organization	67	11	42	41	-
Fines imposed on managers	2	-	-	-	-
Penalty	-	-	-	-	-
Warning	116	26	95	23	2
Revocation of a manager professional qualification license	1	-	-	-	-
Termination of license				6	
Cessation	6	4	29	-	-

** Organizations implementing payment instruments, carrying out money transfers, processing settlement documents and performing clearing operations.*

In performing inspection of financial performance, the CBA Financial Supervision Department l emphasizes the following areas:

1. Banks:
   - system of internal control,
   - risk management system,
   - integrity of corporate management principles,
   - IT sector,
   - assessment of asset quality,
   - transparency,
   - assessment of asset and liability management,
   - fight against legalization of criminal proceeds (money laundering) and terrorism financing,
   - protection of consumer interests.

2. Credit organizations:
   - assessment of asset quality,
   - accounting records,
   - capital components,
   - profitability,
   - liquidity,
   - IT sector,
   - system of internal control,
   - fight against legalization of criminal proceeds (money laundering) and terrorism financing,
   - protection of consumer interests.
3. Insurance companies:
   - real capitalization level of insurance companies,
   - governance of insurance companies (such as internal control, etc.),
   - availability of consumer protection mechanisms,
   - compliance of business operations with new legislative framework;
   - fight against legalization of criminal proceeds (money laundering) and terrorism financing,
   - level of financial sustainability of companies,
   - risk level of reinsurance.
4. Security issuers and reporting issuers:
   - organization and control of Prospectus and/or Trade Prospectus registration procedures,
   - control over protection of transparency, integrity and consistency of information subject to dissemination by reporting issuers,
   - control over compliance of the business operations carried out by persons propounding public offerings of securities with the provisions of legislation.
5. Participants of securities market,
   - issues relating to grouping of securities market participants in compliance with the requirements set forth by the law "On Securities Market", in particular, authorization of investment service rendered by commercial banks, registration and licensing of investment companies, regulated market participants and the Central Depository, as well as compliance of their business operations with the basic requirements of the legislation,
   - issues relating to introduction of the mechanisms for control over business operations and market conduct of the securities market participants in compliance with provisions of the law "On Securities Market",
   - issues on introduction of mechanisms for control and prevention of abuses in securities market (such as price abuse and misuse of internal information for business purposes),
   - issues on prevention of the securities market transactions carried out by non-licensed persons,
   - revision of the top tariffs set against services of the Central Depository.

6. Exchange offices and pawn shops:
   - compliance with the requirements relating to safe and sustainable business operation,
   - quality of rendered services,
   - fight against legalization of criminal proceeds (money laundering) and terrorism financing,
   - protection of consumer interests,
   - compliance of business operations with the law

7. Clearing companies
   - IT sector,
   - fight against legalization of criminal proceeds and terrorism financing
   - protection of consumer interests,
   - system of internal control.

STAFF TRAINING AND COOPERATION WITH SUPERVISORS OF OTHER COUNTRIES

In 2008, the CBA human resource policies were aimed at increasing operational efficiency and raising the level of staff skills.

With the view to strengthening and enhancing professional qualifications, skills and knowledge of the employees involved in the financial system regulation and supervision processes, as well as providing them with information on best practices, the CBA arranged participation of the employees in a number of local and external training courses and conferences. Staff training activities were supported by the International Monetary Fund, banks from Switzerland, Spain, France, German Bundesbank, the Bank of England training center, the USA Federal Reserve System, central banks of Netherlands, Kazakhstan and Russian Federation, the International Settlements Bank, national banks of Poland and Check Republic, Toronto Center, EAEC (Eurasian Economic Cooperation), Financial Stability Institute, etc. The issues reviewed during training courses, conferences and seminars on exchange of work experience involved the anti-crisis governance and financial stability, actual issues relating to banking, insurance, supervision of securities market participants, risk management and assessment, implementation of new supervision procedures, combating money laundering and terrorism financing, and reforms in the financial system regulation.

In 2008, the major themes of the CBA staff training included "Financial Stability", "Financial Infrastructure and Financial Sustainability", "Governance of Financial Crisis", "Financial Supervision", "Financial Programming and Policy", "Major Financial Supervision Issues", "Liquidity Risk", "Banking Supervision and Analysis", "Challenges of Financial System Policies", "Risk Based Inspection", ""Major Supervision Issues", "Anti-Money Laundering and Fight Against Terrorism Financing", "Principles of Securities Market Supervision", "Corporative Regulation Analysis", "Supervision of Clearing Companies", "Licensing and Supervision of Exchange Offices", "Issues on Strengthening Comparability of Securities Statistics", etc.

The CBA employees also visited central banks of other countries, in order to be acquainted with their experience.

The CBA employees participated in international banking and financial conferences and symposiums, forums, "round table" sessions, consultations, exhibitions, working seminars, where they presented reports and speeches.

The events with participation of the CBA representatives include inter alia Coordinating Session of the Central Banks of the OSCE Countries in Tula, meeting of the working group of the Edmond Group countries in Santiago, session of the Anti-Money Laundering and Fight Against Terrorism Financing MONEYVAL Committee in Strasbourg, organizational forum "Management of the CBA Reserves and the

Financial Sector Assets", seminars and consultations in Washington devoted to "Financial Sector Issues and Analysis", meeting of the CIS countries working group on the settlement systems in Basel, the annual meeting and business forum of the European Bank of Reconstruction and Development Board of Governors in Kiev, the annual meeting and the technical assistance program of governors of the countries under the Netherlands umbrella of the International Monetary Fund and the World Bank in Amsterdam, the session of the Anti-Money Laundering and Fight Against Terrorism Financing Eurasian Group in Bishkek, the annual meeting of the Bank of International Settlements Irving Fisher Committee in Basel, the session of the Club of Governors of the Central Banks of the Central Asia, the Black Sea and the Balkan countries in Sarajevo, the annual meeting of the International Monetary Fund and the World Bank Board of Governors in Washington and the international conference "Management of Informational Security" in Amsterdam.

The Central Bank of Armenia continued its participation in the works of the governors of the CIS countries security market regulation bodies. During the last annual session in 2008, it was decided that the sessions in 2009 would be chaired by the Chairman of the Central Bank of Armenia.

With the view to expanding operational cooperation and conducting negotiations, the CBA in 2008 was visited by the experts and representatives of companies "NASDAQ" and "OMX Group", "UBS Global Asset Management", rating agencies "FITCH Ratings" and "Moody's Investors Service Co", Citibank, company De La Rue Cash Systems, USAID, the International Monetary Fund statistical mission (ROSC), specialists of JP Morgan Chase Worldwide Securities Services, and an expert from the Bank of Latvia within the framework of RAMP program.

In 2008, central banks continued the process of signing agreements and memorandums of understanding between each other within the framework of the intergovernmental committees. On August 29, 2008, the Central Banks of Armenia and Iran signed in the capital of the Islamic Republic Iran, Tehran, memorandum of understanding "Om Expansion of cooperation between the republic of Armenia Central Bank and the Central Bank of the Islamic Republic of Iran".

During September 15-19, 2008, the CBA organized and hosted the annual meeting of the heads of the legal departments of the CIS and the Baltic countries central banks, with participation of 14 delegates from nine countries.

On November 21-22, 2008, the CBA organized celebrations dedicated to commemoration of the 15-th anniversary of issuing the Armenian national currency – dram, within the framework of which it arranged a round-table "Financial Stability in the Changing World". The celebration events were attended by 23 representatives from 13 countries (including three governors and six deputy governors), as well as delegation from the International Monetary Fund.

It is peculiar from the CBA internal training point of view that in response to training proposals made by the international experts, the CBA took a decision that beginning from 2007 the most experienced supervision specialists of the CBA would arrange training courses in order to pass their experience and knowledge to the younger colleagues.

In 2008, several specialists from the CBA attended the training course FSI connect, arranged by the Swiss Financial Stability Institute (FSI) in an on-line format. At the end of each seminar, participants passed an examination based on the principle of multiple choices. Starting from 2007, the CBA introduced and implemented new principles for qualification and professional growth of the specialists involved in the financial sector supervision, according to which the financial sector supervision sector will employ or promote only the employees who will successfully complete the training. Training includes the following range of subjects: "Capital and Basel 2", "Credit Risk", "Market Risk", "Operational Risk", "Accounting", "Clearing Systems" and "Other Supervision Issues". Each subject is delivered at three levels – basic, intermediate and advanced.

Given the importance of increasing the level of regulation, strengthening control and improving efficiency of the national financial system, the CBA always stressed the significance of life long training and education of staff, in cooperation with foreign partners.

FINANCIAL INSTITUTIONS IN 2008

COMMERCIAL BANKS

GENERAL PROVISIONS

Domestic banks

As of end-December 2008, there were 22 commercial banks operating in Armenia, with 381 branches (34 more branches than in the previous year).

Over the year, the banking system[7] financial intermediation indicators grew substantially. As of 31.12.2008, the share of the banking system total assets in GDP was 28 percent, and the share of loans in GDP was 16.9 percent, compared to 24.3 and 13.0 percent respectively of the previous year.

Banking system concentration

In 2008, the concentration level in the banking system continued to fell. The Herfindahl-Hirschman Index of Concentration[8] dropped further. For various system indicators, it is set within 0.06-0.1 range, reflecting a comparatively low level of concentration in the banking system.

Table 3. The Herfindahl-Hirschman Index of Concentration

Indicators	31.12.06	31.12.07	31.12.08
Total assets	0.08	0.08	0.07
Total liabilities	0.09	0.08	0.08
Total capital	0.07	0.07	0.06
Loans to economy	0.08	0.09	0.08
Time deposits of natural and legal persons	0.10	0.09	0.09
Demand deposits of natural and legal persons (including bank accounts)	0.15	0.11	0.10

[7] *There were 22 commercial banks.*

[8] *The Herfindahl - Hirschman Index of Concentration can have values within the range of 0-1 and describes the level of concentration (values close to 0 indicate low level of concentration).*

Throughout the year, the polarization between the banks contracted a little. In the beginning of the year, the share of the 10 largest banks' total assets in the total assets of the banking system was 77 percent and the share of the 4 largest banks' total assets within those was 45 percent, while at the end of the year these figures dropped to 76 percent and 44 percent respectively. Polarization of loans, as well as term and demand liabilities to natural and legal persons also contracted, both in terms of 10 and 4 largest banks.

Table 4. Banking sector concentration level (in %)

Indicators	31.12.06	31.12.07	31.12.08
Total assets			
CC 4 (share of assets of the 4 largest banks' assets within total assets of the banking system)	46	45	44
CC 10 (share of assets of the 10 largest banks' assets within total assets of the banking system)	80	77	76
Total liabilities			
CC 4	49	46	46
CC 10	84	80	80
Total Capital			
CC 4	38	41	38
CC 10	67	67	66
Loans to economy			
CC 4	47	50	48
CC 10	83	83	79
Time deposits of natural and legal persons			
CC 4	49	41	40
CC 10	87	81	79
Demand deposits of natural and legal persons (including bank accounts)			
CC 4	57	51	47
CC 10	85	81	78

The level of competitiveness in the Armenian banking system during 2008 was assessed based on the model designed by Panzar and Ross[9]. Panzar-Ross model was used to assess the impact of expense factors on interest income, such as impact of wage expenses, fixed assets and interest

[9] Panzar and Ross model is based on the theoretical models for competition, monopolistic competition and monopoly. According to the model, the growth of input factor prices in monopolistic market leads to the growth of marginal expenses, which leads to the reduction of yield and total income (because the participants are willing to reduce the acquisition of input factors at high prices). In the competitive market, the growth of input factor prices leads to the same growth of marginal expenses and income. In an oligopolic competition environment, the growth of input prices results in a smaller non-proportional growth of income.

expenses, using the banking system data for 2003-2008. The value of H-statistic[10] indicator which is the sum of ratios assessing the impact of expense factors on interest income is 0.3 for Armenian banking sector. This proves the existence of oligopolic competition elements.

BANKING SYSTEM CAPITAL

Capital Growth Trends

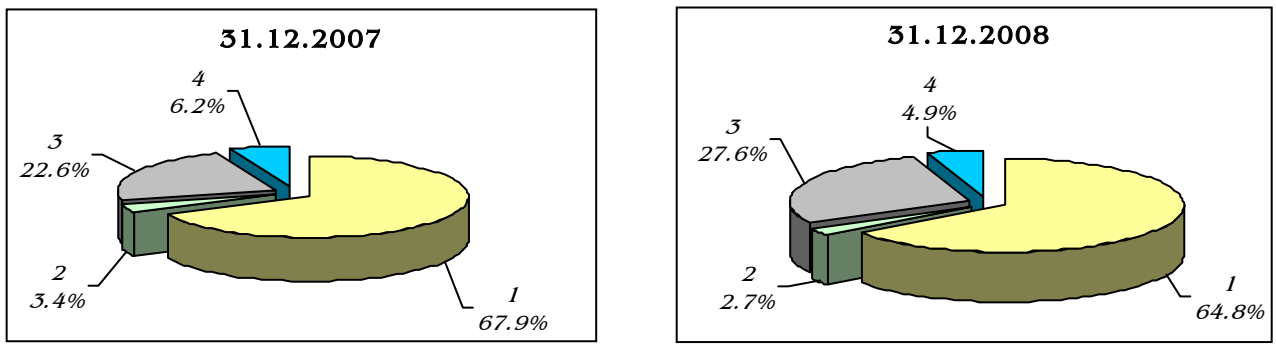
Over the reporting year, total capital of the banking system grew by 37.2 percent (63.8 billion drams), and totaled 235.4 billion drams.

Growth of the total capital was mainly driven by the growth of the banking system profit and statutory capital.

In 2008, 11 banks boosted their statutory funds, in overall by 36.0 billion drams. The major share of the growth (34.0 billion drams) was the financing from foreign sources, as a result of which the share of non-residents within the total statutory capital of the banking system grew and totaled 68 percent against 58 percent in the beginning of the year.

In 2008, net profit of the banking system totaled 26.9 billion drams.

Chart 1. The Structure of the Banking System Total Capital



1. Actually paid-up statutory capital, 2. General reserve, 3. Retained profit (over the current and the previous periods), 4. Other

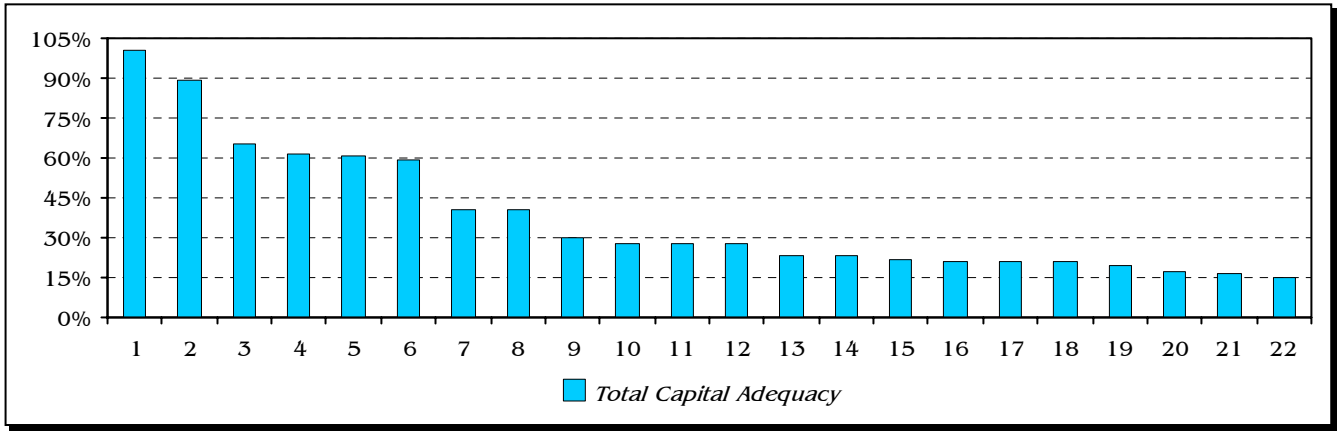
[10] *The value of H-statistic, calculated using Panzar and Ross model, reflects the level of market competitiveness. Where the H-statistic value is close to 1, market is considered perfectly competitive, the 0<H<1 range reflects oligopolic competition, while the value of H-statistic below zero means the market is monopolistic.*

The growth of total liabilities was a little behind the growth of total liabilities. As a result total capital to total liabilities coefficient (leverage) grew by 0.9 percentage points and totaled 29.9 percent at the end of the year.

Banking system capital adequacy

In the beginning of 2008, a modified prudential standard on banking total capital adequacy was introduced, which incorporated major provisions of the Basel 2 Accord's standardized approach. In particular, the calculation of capital adequacy included not only credit risk, but also market and operational risks. At the same time, the growth of loans over the year was higher than the capital growth. As a result, total capital adequacy indicator during the year fell by 2.6 percentage points and totaled 27.5 percent.

Chart 2. Total Capital Adequacy of Banks



Shareholders of commercial banks

There are 22 commercial bank in Armenia of which 1 is a limited liability company, 3 are open joint-stock companies and 18 are closed joint-stock companies.

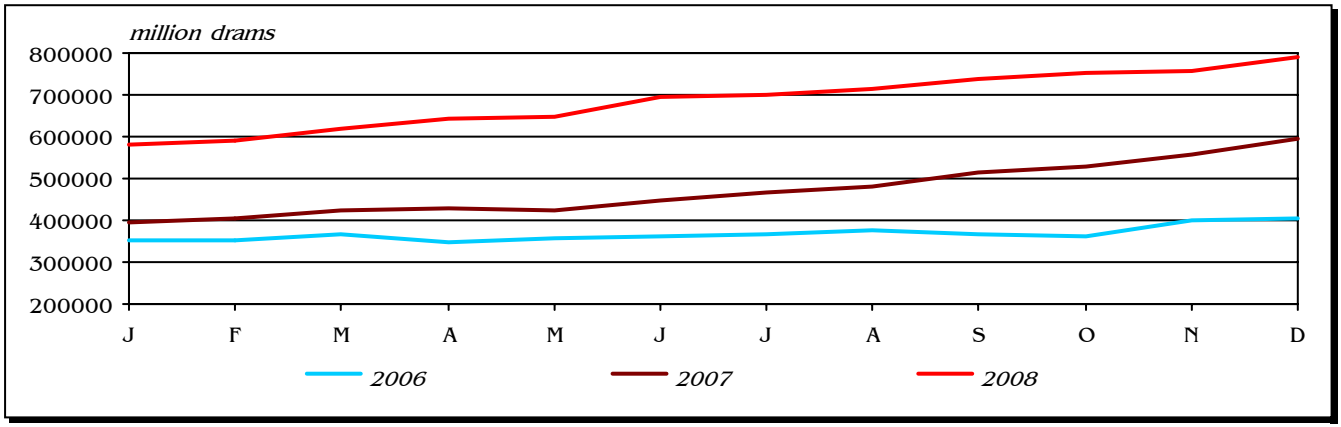
Participants (shareholders, equity holders) of the Armenian banking system are 1,652 natural and legal persons, of which 83 are non-residents. Except 3 banks which have the status of open joint-stock companies, participants of the remaining 19 banks are 78 natural and legal persons, of which 37 are non-residents. In five banks, 100 percent of shares are owned by a single person (one resident legal person, three non-resident legal persons and one non-resident natural person), while in 8 other banks a single shareholder owns more than 50 percent of the shares.

Borrowed funds

In 2008, total liabilities of the banking system grew by 33.0 percent (195.4 billion drams) and at the end of the year totaled 788.3 billion drams.

Dram liabilities grew by 15.5 percent, while foreign exchange liabilities grew by 51.7 percent, as a result of which the share of dram liabilities at the end of the year fell by 6.8 percentage points and totaled 44.9 percent.

Chart 3. Banking System Liabilities



The growth of liabilities was mainly driven by the growth of liabilities to banks (124.5 billion drams) and total deposits (50.9 billion drams).

Loro correspondent accounts of the banks dropped by 24.8 percent (by 18 billion drams). At the end of the year, 46 percent of loro accounts were the share of non-resident banks. 54 percent of non-resident banks' loro accounts belonged to Russian banks, while 38 percent to the Iranian banks.

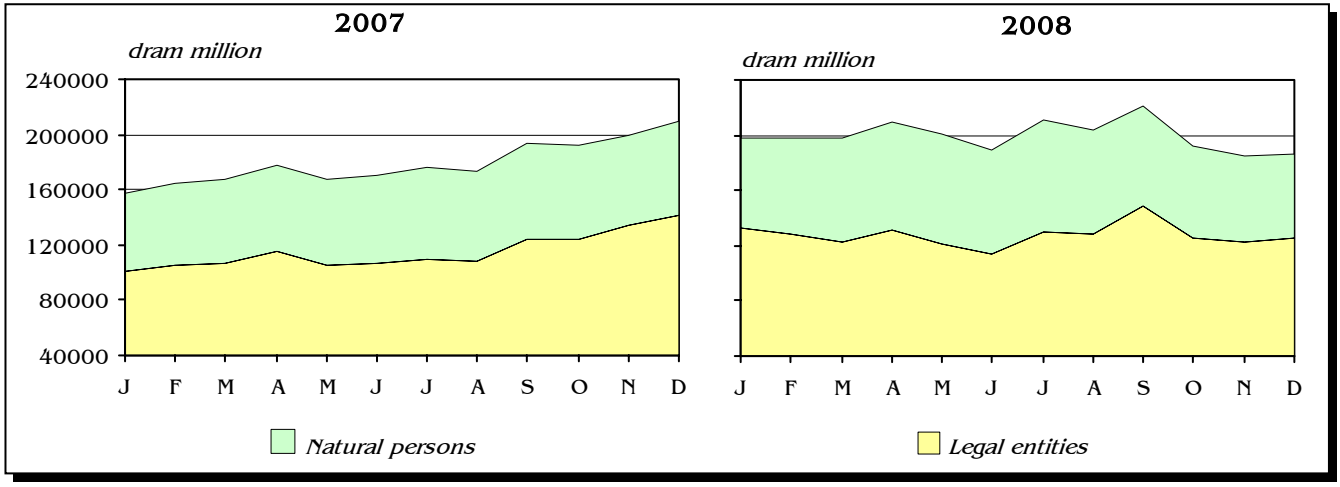
As of 31.12.2008, total deposits (term and demand) attracted from natural and legal persons, totaled 449.5 billion drams.

In contrast to the progressive growth trends of the dram deposits during the preceding years, the growth of deposits in 2008 was fully driven by the growth of foreign exchange deposits. Foreign exchange deposits grew by 37.6 percent (by 63.1 billion drams), while dram deposits fell by 5.3 percent (12.2 billion drams).

Over the reporting year, demand deposits of natural persons and legal entities fell by 11.9 percent (by 16.9 billion drams) and 8.9 percent (6.1 billion drams) respectively. However, the number of current accounts held by the legal entities grew by 18.2 percent, while the number of current

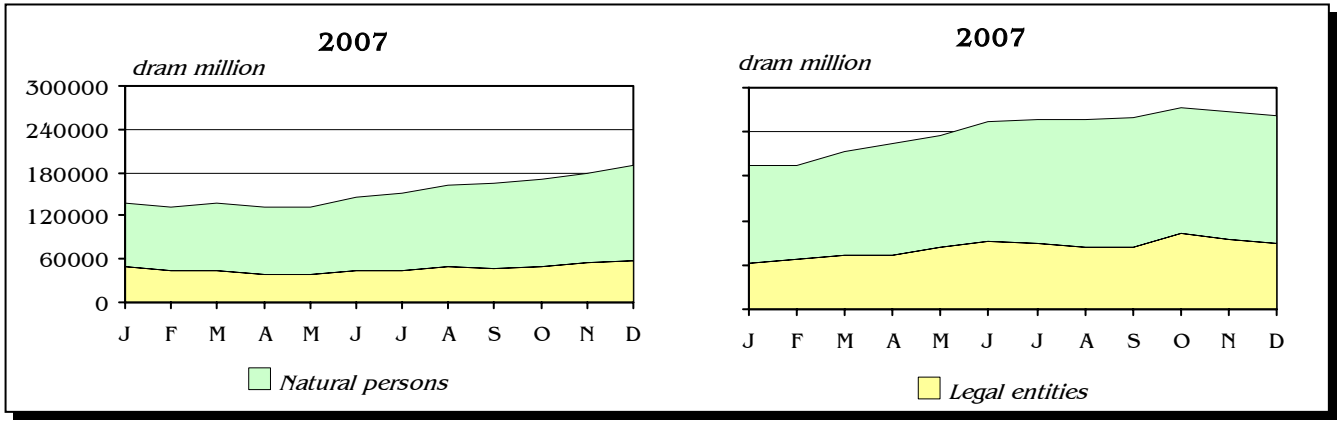
accounts of natural persons grew by only 0.5 percent, which proves that the volume of natural persons' accounts shrank.

Chart 4. Demand Deposits



The volumes of natural persons' and legal entities' time deposits grew by 51.6 percent (by 30.2 billion drams) and 33.6 percent (by 43.7 billion drams) respectively, while the number of term accounts grew by 31.1 percent and 13.3 percent respectively, reflecting certain trends of the time deposits enlargement both in terms of natural and legal persons.

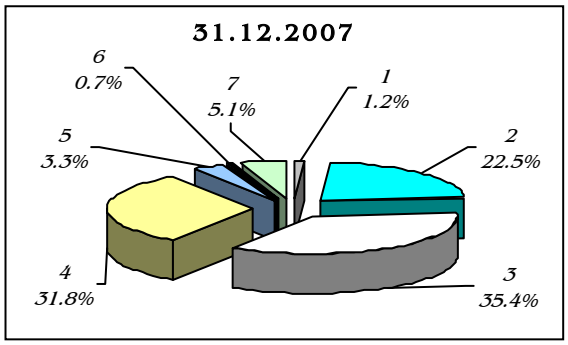
Chart 5. Time deposits

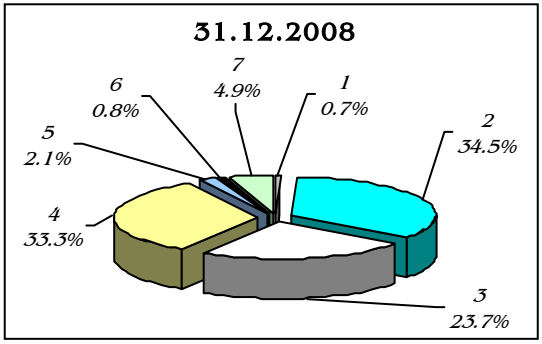


Structure of banking system borrowed funds

As of December 31, 2008, the share of the income-bearing liabilities within the total liabilities of the banking system totaled 95.0 percent (compared to 92.4 percent in the previous year). Over the year, demand liabilities dropped, hence, excluding demand deposits with the low cost paying, the share of cost incurring time deposits compared to the previous year grew by 14.4 percentage points reaching 71.0 percent by the end of the year.

Chart 6. Structure of the Banking System Total Liabilities





1. Bank correspondent accounts, 2. Other liabilities to banks (including CBA) and other financial institutions,3. Demand liabilities, 4. Time deposits, 5. Liabilities to the Republic of Armenia government,6. Interests payable, 7. Other liabilities

As of 31.12.2008, 26 percent of the borrowed funds were on demand terms (deposits, banking accounts, correspondent accounts and etc.), 53 percent were time deposits with a maturity of up to 1 year, and 21 percent were time deposits with a maturity over 1 year.

Within the structure of the banking system total liabilities, the share of the demand deposits of natural persons and legal entities dropped significantly (by 11.7 percentage points), while liabilities to banks and other financial institutions grew (by 12.0 percentage points).

Commercial banks' customers

Over 2008, the number of the customers serviced by the Armenian commercial banks grew by 8.7 percent (by 81.2 thousand), of which the number of legal entity customers grew by 13.3 percent (by 6.0 thousand), and the number of natural person customers grew by 8.5 percent (by 75.2 thousand).

By the end of the year, the number of natural person customers totaled 963.7 thousand, while the number of legal entity customers grew by 51.4 thousand.

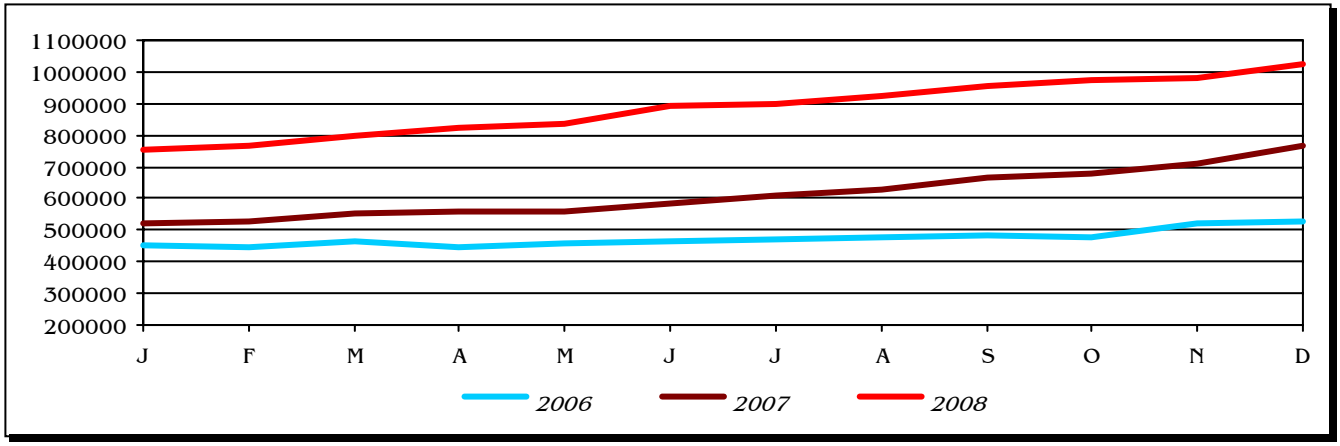
Over the year, the number of the banking accounts grew by 25.4 percent and totaled 1.4 million, of which 77 percent were current accounts and 23 percent were term accounts. The number of current accounts grew by 1.7 percent or 17.4 thousand (mainly driven by the growth of the accounts of legal entities) and totaled 1,068.1 thousand by the end of the year. The number of time deposits grew by 13.6 percent or by 7.3 thousand (mainly driven by the growth of the accounts of households), and by the end of the year totaled 60.9 thousand. Over the past few years, the banking system observed a trend of natural persons' time deposit steady growth both in volume and number. This was also driven by the deposit insurance system.

BANKING SYSTEM ASSETS

Growth trends of financing provided by the banking system

Over 2008, total assets of the banking system grew by 33.9 percent (by 259.2 billion drams), and totaled 1.23 trillion drams at the end of the year.

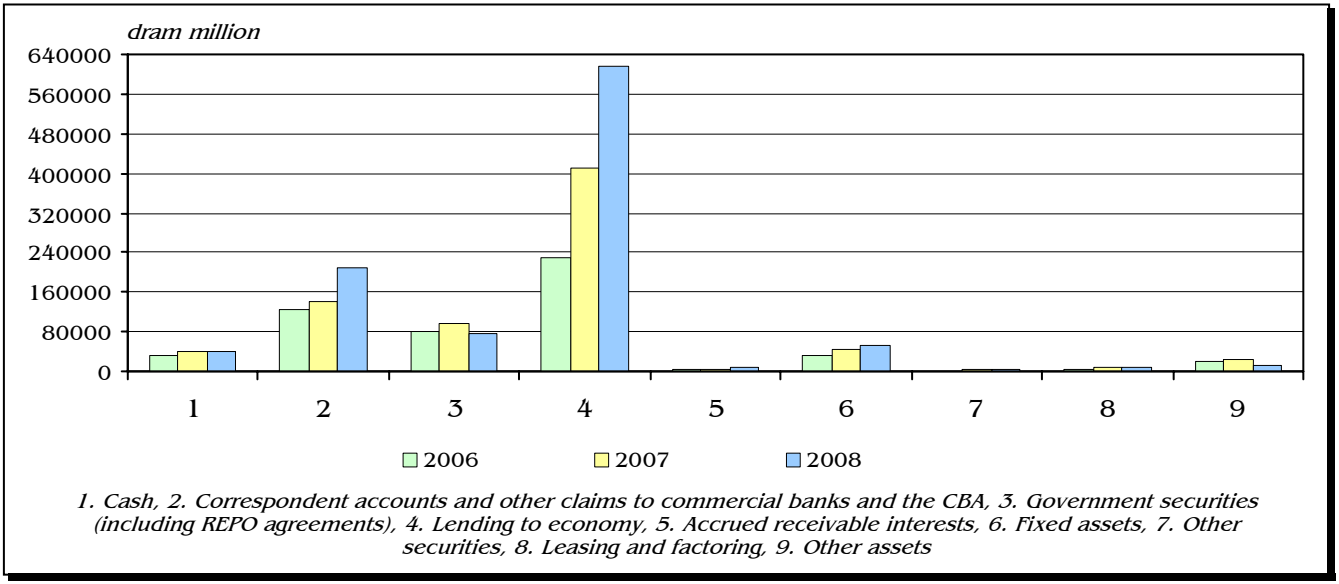
Chart 7. Total Assets of the Banking System



80 percent of the total asset growth is the share of the lending to economy. The trends of the former 4 years on growth of lending higher than total asset growth were preserved. Over the year, lending to economy grew by 51 percent (by 208.1 billion drams). The share of loans within total assets at the end of the year reached 60.3 percent, compared to 53.5 percent at the beginning of the year.

Correspondent accounts held in the CBA grew by 38.6 percent (by 29.0 billion drams); nostro correspondent accounts in other banks grew by 86.0 percent (by 35.1 billion drams). Nostro correspondent accounts have a high level of concentration, both in terms of geographic breakdown and residency. At the end of the year, 96.2 percent of correspondent accounts were kept in non-resident banks (compared to 96.3 percent in the previous year). The shares of correspondent accounts held in American, European and Russian banks within the total accounts of non-resident banks were 40, 38 and 11 percent respectively (compared to 33, 41 and 11 percent as of 31.12.2007). The rest of accounts (11 percent) are held in the banks of other countries.

Chart 8. Banking System Assets



1. Cash, 2. Correspondent accounts and other claims to commercial banks and the CBA, 3. Government securities (including REPO agreements), 4. Lending to economy, 5. Accrued receivable interests, 6. Fixed assets, 7. Other securities, 8. Leasing and factoring, 9. Other assets

The investment in government securities (including REPO agreements) fell by 20.0 percent (19.0 billion drams), and at the end of the year totaled 76.0 billion drams. Parallel to the contraction of banking investments into government securities, credit investments grew.

The volumes of investments in other securities grew by 688 million drams and at the end of the year totaled 3.4 billion drams.

Over the year, the banking system fixed assets grew by 21.7 percent and at the end of the year totaled 58.1 billion dram, or 22.0 percent of total capital. The amount of fixed assets was smaller than the amount of total capital in all Armenian commercial banks, proving that the banks did not acquire fixed assets at the expense of borrowed resources.

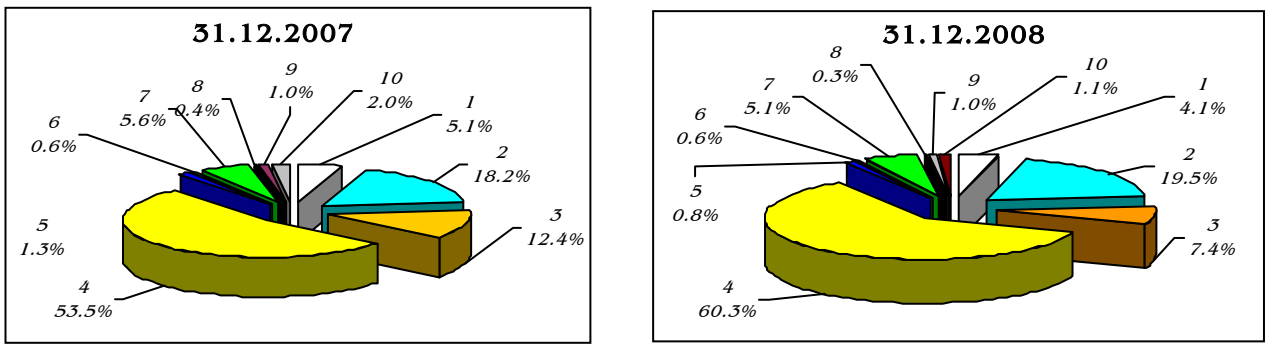
Structure of the financing allocated by the banking system

As of 31.12.2008, the share of assets with high return within total assets totaled 78.3 percent (compared to 76.6 percent as of 31.12.2007). If correspondent accounts with low yield are excluded, the share of other high return assets would be 72.0 percent (compared to 76.6 percent at end-December 2007).

Within the structure of assets, the share of investments into government securities and loans shrank. The growth of lending to economy in 2008 exceeded that of the total assets, resulting in 6.8 percentage point growth of the share of loans within assets. The share of investments into government securities dropped by 5.0 percentage points.

In 2008, the maturity structure of the funds allocated by the banking system remained almost unchanged. As of December 31, 2008, 23 percent of the allocated funds were on demand terms, 40 percent had a maturity of 1 to 12 months, and 37 percent had a maturity over 1 year, or were on demand terms (compared to 21, 44 and 35 percent, respectively in the previous year).

Chart 9. Structure of the Banking System Assets



1. Cash, 2. Correspondent accounts and other claims to commercial banks and the CBA, 3. Government securities (including REPO agreements), 4. Lending to economy, 5. Claims to non-bank financial institutions, 6. Accrued receivable interests, 7. Fixed assets, 8. Other securities, 9. Leasing and factoring, 10. Other assets

Banking system credit investments

Banking system credit investments[11] grew by 44.9 percent (201.7 billion drams) and totaled 650.7 billion drams. Dram credit investments grew by 50.0 percent, while foreign exchange credit

[11] *Credit investments include lending to economy, leasing, factoring, as well as borrowings to and deposits in the financial institutions.*

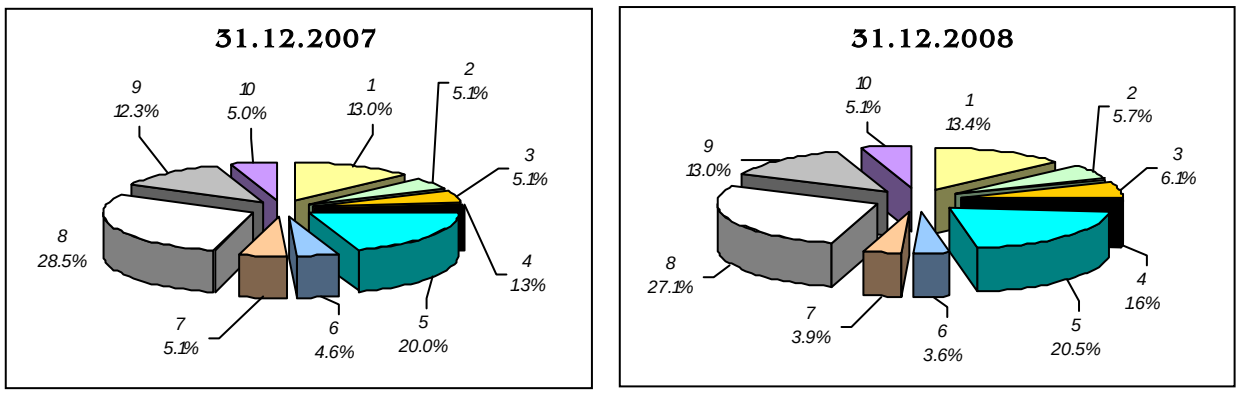
investments grew by 37.6 percent. As a result, the share of dram credit investments within total credit investments grew by 2.0 percentage points and at the end of the year reached 61.3 percent.

Credit investments to non-residents dropped by 45.5 percent and totaled dram 7.9 billion. Credit investments to residents grew by 48.0 percent and totaled 642.8 billion drams.

During 2008, credit investments grew in all sectors of economy. Industry lending grew by 52.6 percent (29.6 billion drams), agriculture 63.0 percent (14.1 billion drams), construction 79.2 percent (17.4 billion drams), transport and communications 75.0 percent (4.4 billion drams), trade 52.1 percent (45.2 billion drams), public catering and other public services 14.6 percent (2.9 billion drams), Consumer and mortgage loans grew by 41.2 percent (50.9 billion drams) and 56.7 percent (30.2 billion drams) respectively.

Banking system loans are mainly concentrated within consumption, trade, real estate and industrial sectors.

Chart 10. Structure of Loans Extended to Residents and Receivable Debts by Sectors of Economy



1. Industry, 2. Agriculture, 3. Construction, 4. Transport and Communications, 5. Trade, 6. Public catering and other public services, 7. Financial sector, 8. Consumption, 9. Mortgage, 10. Other sectors

The Herfindahl-Hirschman concentration coefficient of lending the economic sectors dropped slightly compared to the previous year (by 0.002) and totaled 0.165, mainly due to a rapid growth of mortgage loans that had a small share in total loans. The average concentration by banks was 0.209, which shows a relatively high level of the sectoral concentration of lending in a number of banks.

Over the reporting year, the share of long-term loans (with the maturity of 1 year and more) in total credit investments grew by 7.8 percentage points and totaled 74.0 percent.

During the recent years, the share of long-term loans within the structure of loans grew. The long-term target loans provided by the mediation of the banks within the framework of projects supported

by the international financial institutions partly contributed to the satisfaction of demand on long-term loans. As of 31.12.2008, 18 banks and 3 credit organizations operating in Armenia serviced nearly all the credit projects supported by the following international financial institutions:

- ✓ the World Bank,
- ✓ German-Armenian Fund,
- ✓ European Bank of Reconstruction and Development,
- ✓ International Fund of Agricultural Development,
- ✓ International Migration Organization,
- ✓ Asian Development Bank,
- ✓ Black Sea Trade and Development Bank,
- ✓ OPEC International Development Fund,
- ✓ Agricultural Financing Structure Projects Implementation Unit,
- ✓ Other international financial institutions.

In 2008, loans provided by the mediation of the banks within the framework of the projects supported by foreign institutions grew by 114 percent and at the end of the year totaled 83 billion drams. As of December 31, 2008, the share of the overdue loans within those loans was 0.6 percent. Around 87 percent of the loans had a maturity over one year, 11 percent were with a maturity from 6 months to one year and 2 percent with a maturity up to 6 months.

As of December 31, 2008, the major sectors that received loans were the trade sector (37 percent), agriculture (17 percent), consumption (20 percent), food (11 percent) and mortgage loans (10 percent).

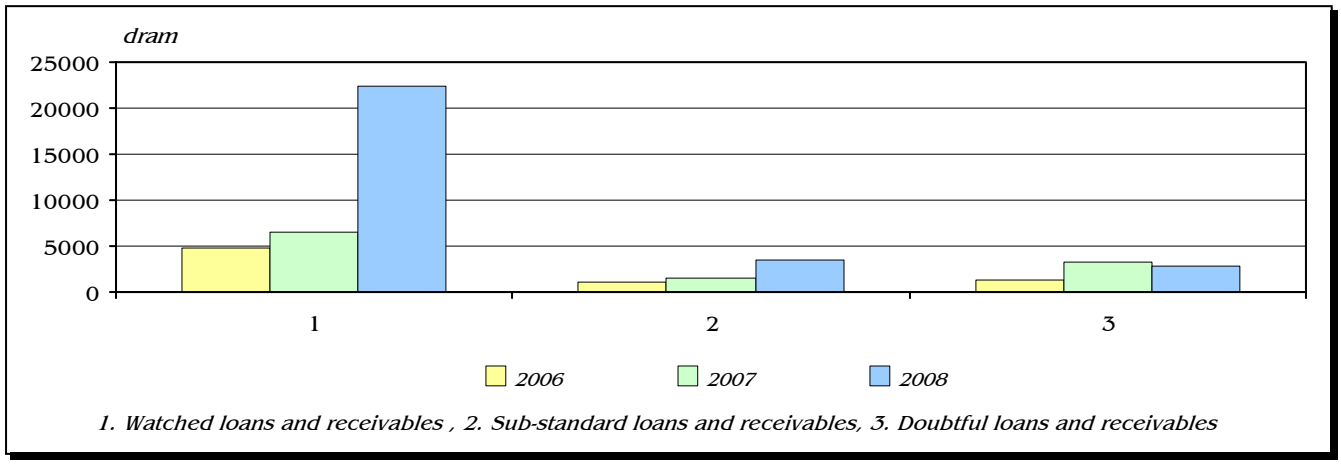
Quality of credit portfolio

During 2008, the amount of non-performing loans (watched, sub-standard and doubtful) and receivables grew by 17.5 billion drams and totaled 28.9 billion drams, while the amount of standard assets grew by 233.6 billion drams and totaled 702.6 billion drams. During the reporting year, the share of non-performing assets within the total assets grew by 1.5 percentage points and totaled 3.9 percent.

At the end of the year, 1.5 percent of the non-performing assets belonged to non-residents, while 98.5 percent belonged to residents. Within the resident investments the share of non-performing assets was relatively high in the construction sector (8.7 percent), public catering and other public services (6.8 percent) and industry (6.4 percent).

The share of non-performing assets was low in the trade and agricultural sectors, 2.7 and 2.1 percent, respectively.

Chart 11. Banking System Non-Performing Assets



1. Watched loans and receivables , 2. Sub-standard loans and receivables, 3. Doubtful loans and receivables

BANKING SYSTEM FINANCIAL PERFORMANCE

Banking System Profitability

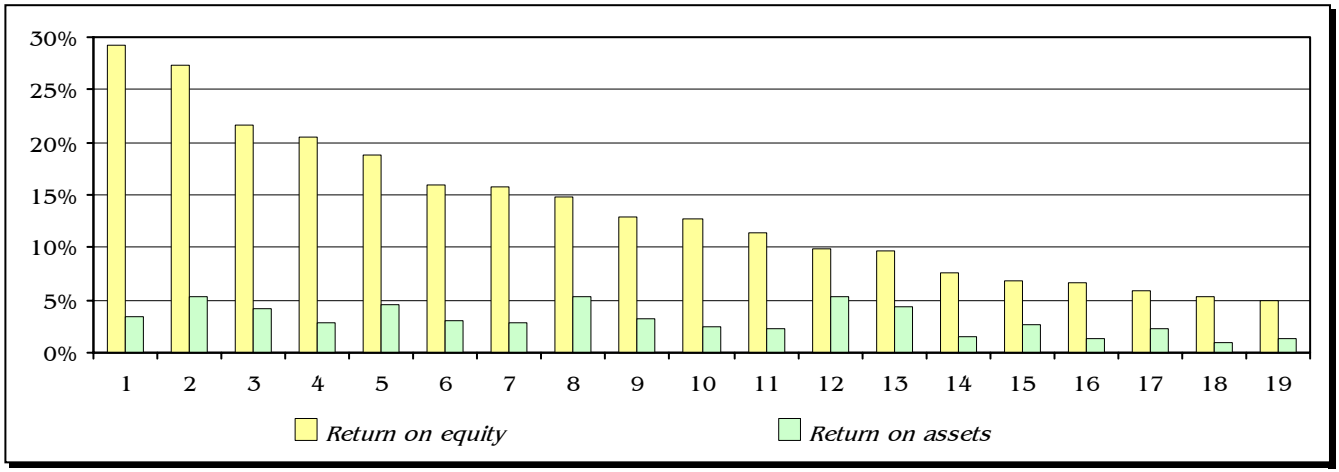
In 2008, net profit of the banking sector totaled 26.9 billion drams. During the year, 19 banks operated with profit, with the total amount of net profit totaling 28.9 billion drams.

Compared to the previous year, the banking system profitability indicators were a bit lower, mainly due to the contraction of demand liabilities and interest margin. Banking system return on assets (net profit to average annual assets ratio) totaled 3.0 percent, while return on equity (net profit to average annual equity ratio) totaled 13.4 percent. The same indicators in 2007, totaled 3.4 percent and 14.8 percent respectively. Over the year, banking system net operational margin[12] dropped by 0.5 percentage points and totaled 4.5 percent.

The Herfindahl-Hirschman index of concentration for 19 banks that operated with profit grew by 0.02 over the previous year and totaled 0.12. This indicator reflects a not high level of concentration in the banking sector in regard to profit.

[12] *Net operational margin is equal to the net interest and net non-interest income to average annual total assets.*

Chart 12. Profitability for 19 Profitable Banks

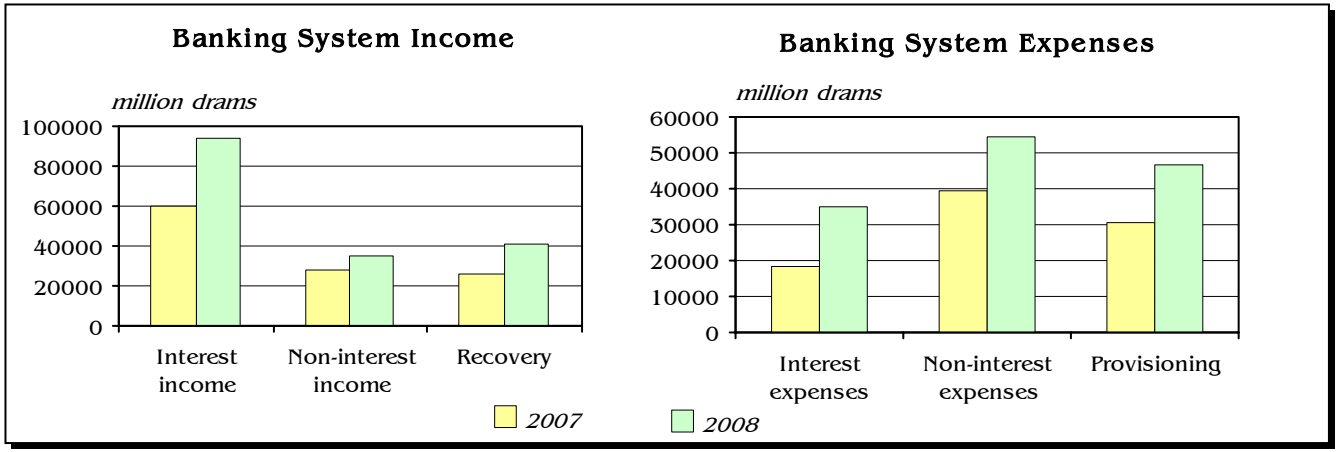


Structure of Income and Expenses

Compared to the previous year, the banking sector profits in 2008 grew by 29 percent (or by 6.0 billion drams), mainly due to the growth of income on interest in consequence of significantly higher lending.

Compared to the previous year, gross income in 2008 grew by 49.8 percent (or by 56.9 billion drams), while gross expenses grew by 54.9 percent (48.3 billion drams).

Chart 13. Banking System Income and Expenses

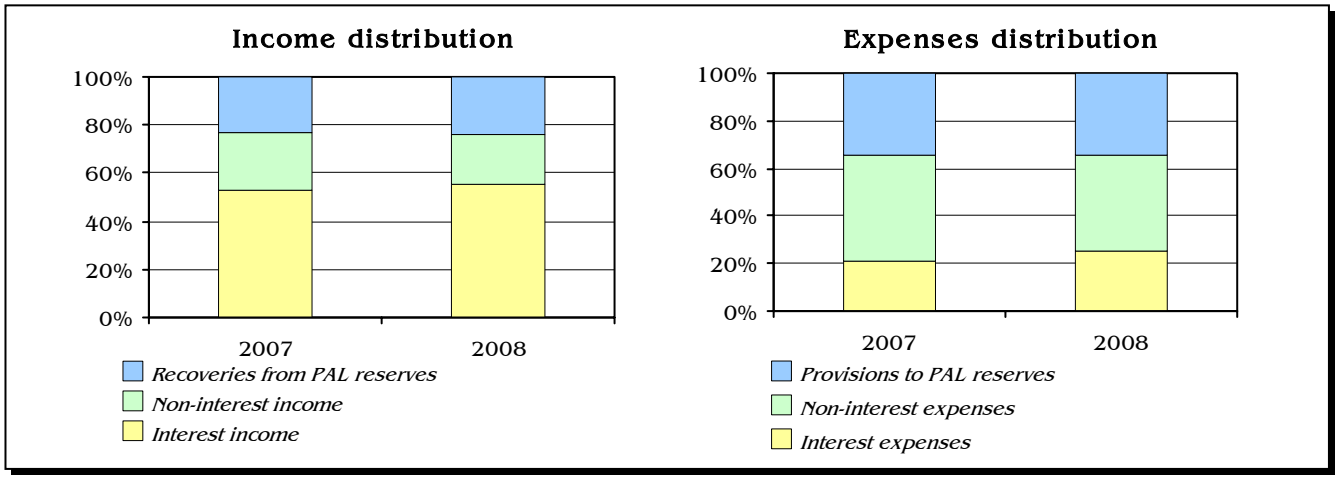


Within gross income, income on interest grew by 56.3 percent, non-interest income by 27.9 percent, while recoveries on the reserve for possible asset losses (PAL) grew by 57.8 percent.

Compared to the previous year, expenses on interest grew by 91.4 percent, non-interest expenses by 39.0 percent, while the provisions to the possible asset losses reserve grew by 53.8 percent.

As a result of the growth of the mentioned income and expenses, the share of income on interest in total income grew by 2.3 percentage points, while the share of interest on expenses in total expenses grew by 4.6 percentage points.

Chart 14. Structure of Banking Sector Income and Expenses



The growth of the banking sector interest income was mainly driven by 61.0 percent growth of income on loans provided to economy. The share of income on loans provided to economy within total interest income grew by 2.4 percentage points and totaled 83.8 percent.

The growth of the banking sector non-interest income was mainly driven by 69.5 percent growth of income on foreign exchange trade. The share of income on mediation fees within non-interest income was 44.9 percent, while the share of income on foreign exchange trade was 41.4 percent.

The growth of the banking sector interest expenses was mainly driven by 78.3 percent growth of interest expenses on time deposits, the share of which within total interest expenses was 50.5 percent.

The growth of the banking sector non-interest expenses was mainly driven by 40.1 percent growth of wages and other payments deemed equal thereto, which accounted for 45.6 percent of non-interest expenses. In 2008, the growth of the banking sector average wages continued. Parallel to 40 percent growth of wages, the number of employees in the banking sector grew by 18.7 percent.

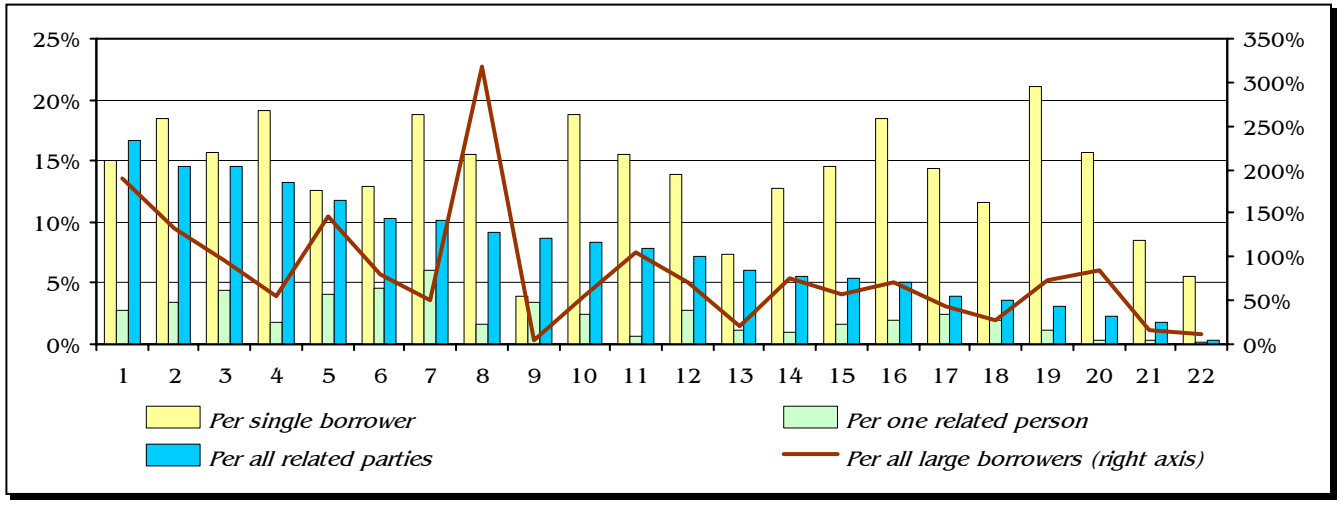
BANKING SECTOR FINANCIAL RISKS

Irrespective of the global financial and economic crisis, the risks of the Armenian commercial banks in 2008 were at a manageable level. Like in the previous year, in 2008 also the growth of the banking system loans exceeded the growth of the assets, however without a notable negative impact on credit and liquidity risks.

Credit risk

Among financial risks peculiar to the banking sector, proper management of credit risk is crucial. Although various assessments indicate that given the upsurge of lending in the recent years and the impacts of the global financial and economic crisis on Armenian economy, the quality of loans in 2008 could deteriorate significantly. However, no essential deterioration took place. In 2008, the share of "watched", "sub-standard" and "doubtful" loans (hereinafter referred as non-performing loans) grew by 2.0 percentage points and totaled 4.4 percent. The non-performing assets (loans and payables) totaled to 13.5 percent of the total capital (7.6 percent in the previous year). Assuming the exclusion of 5.2 billion dram possible asset losses reserve from 28.8 billion dram non-performing assets, the remaining part of the non-covered non-performing assets would be equal to 11.5 percent of the regulatory capital. Subsequently, in case of applying a stress-scenario under which all classified assets are written off (the value of collaterized assets is not considered), the banking system loss would not exceed 11.5 percent of the regulatory capital.

Chart 15. Norms by Banks



During 2008, the share of net provisions to reserve within total assets totaled 0.5 percent only (compared to 0.6 percent in the previous year).

The credit investments by sectors of economy are not much concentrated, with consumer loans (27.1 percent) and trade sector loans (20.5 percent) having the highest share.

As of December 31, 2008, the banking system maximum risk per single borrower totaled 13.5 percent of regulatory capital, per large borrowers 85.5 percent, per single related party 2.5 percent and per all related parties 8.4 percent. These indicators prove that the risks are manageable.

Foreign exchange risk

In 2008, the average annual level of the dram appreciation against the US dollar was 11.5 percent, with 0.8 percent end-of-period depreciation (end-December 2008, compared to end-December 2007).

Reflected by the fluctuations of the dram exchange rate against other currencies, in 2008 the banking system incurred 891 million dram currency revaluation loss, which was equal to 0.4 percent of the banking system regulatory capital (the loss of the previous year was equal to 0.1 percent of the banking system regulatory capital). Loss from revaluation of currency took place in 14 banks, while 8 banks had revaluation profit. It is worth mentioning that during 2008, the banking system had 14.6 billion dram income from foreign exchange trade (70 percent growth compared to the previous year).

Calculations in accordance with the foreign exchange risk assessment VAR (Value at risk) methodology as of December 31, 2008, show with 95 percent probability that possible daily losses on currency revaluation will not exceed 145 million drams.

Liquidity risk

In 2008, the volume of the banking system highly liquid assets shrank, because like in the previous years, loans grew faster than assets.

Over the year, the volume of highly liquid assets of the banking system contracted by 8.2 percent and as of December 31, 2008, totaled 222.8 billion drams.

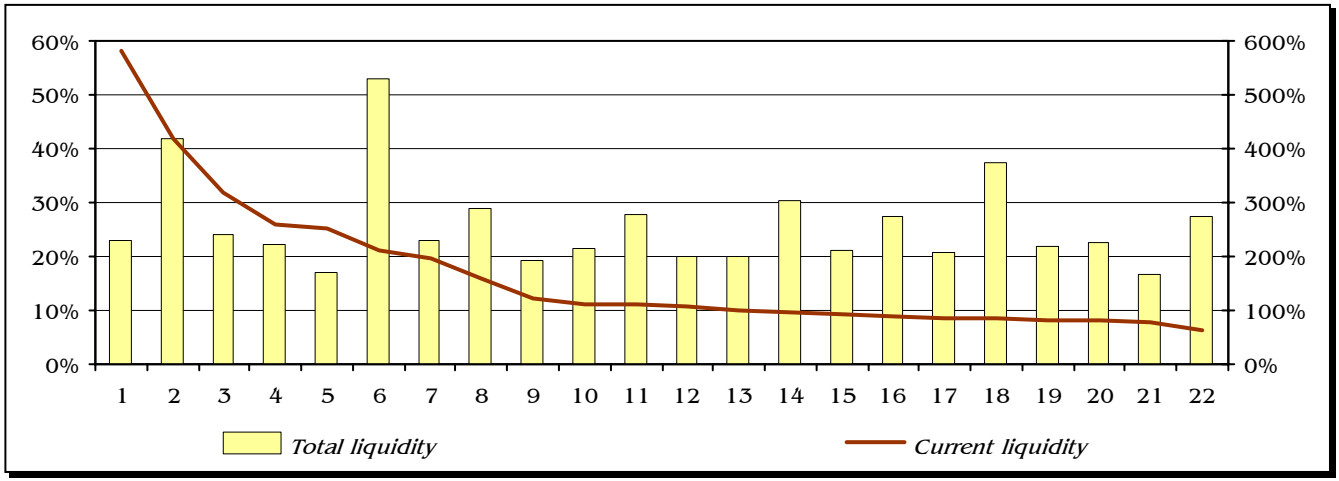
Subsequently, the banking system indicator on total liquidity (highly liquid assets to total assets ratio) fell by 9.8 percentage points and by the end of the year totaled 23.8 percent. Despite of the highly liquid assets decrease, demand liabilities contracted even stronger, hence, the banking system indicator on current liquidity (highly liquid assets to demand liabilities ratio) grew by 4.9 percentage points and totaled 103.1 percent.

Total and current liquidity indicators were above the prudential standard margin and did not pose liquidity risks.

From the liquidity point of view, it is important that the banking system liabilities do not fully rely on large depositors and concentrations of the banking system liabilities are excluded. Over 2008, the share of "large" liabilities[13] grew by 2.3 percentage points and totaled 32.7 percent.

[13] *The sum of all the funds, which all separately exceed 5 percent of the bank's total liabilities, without taking into account their interrelation.*

Chart 16. Liquidity Indicators of Banks



Price risk

Price risk in the Armenian banking system is at a low level. In 2008, the banking system did not incur losses associated with price risk.

At the end of the year, banking system investments in the relatively risky non-government securities totaled 3.4 billion drams, or 1.6 percent of the regulatory capital, and therefore even sharp fluctuations of prices on these securities will not have a strong adverse impact over the banking system.

Revaluation of the financial assets kept for trade and available for sale resulted in 457 million dram net income of the banking system in 2008, while revaluation of the fixed assets resulted in 0.5 million net income.

Minor fluctuations of prices on the fixed assets will not lead to high losses either. Assuming that market prices on the fixed assets drop by 30 percent, the immovable property revaluation losses of the banking system would be equal to 7.4 percent of regulatory capital. As of end-December 2008, the value of the fixed assets totaled 51.8 billion drams, and the value of debtor seized real estate 520 million drams. The impact of real estate price drop on credit portfolio was also assessed. According to stress tests, a failure to recover 50 percent of vulnerable credit portfolio[14], given 30 percent devaluation of market prices on real estate, could lead to 10 percent loss of the total banking system regulatory capital.

[14] *Vulnerable credit portfolio is the sum of the balance on loans with book value exceeding 30 percent of the devaluated value of real estate collaterized against them.*

Interest rate risk

Over the recent years, the weighted average maturity gap of the banking system assets and liabilities almost did not change, remaining around the 6 months range. However, parallel to the slight growth of the average maturity on assets, average maturity on liabilities grew as well.

Interest rate risk of the banking system is at a manageable level, as the average maturity of assets and liabilities is short, hence, in case of changes in market interest rates, the banking system can quickly respond and modify interest rates. According to the calculations of interest rate risk based on duration methodology, 1 percent growth of total market interest rates (both assets and liabilities), would narrow economic value of the banking system capital by 1.1 billion drams.

CREDIT ORGANIZATIONS [15]

In 2008, four companies were granted with the license for carrying out credit organization business activities, namely "VTB Leasing" CJS leasing credit company, "CARD Agrocredit" CJS universal credit company, "Unileasing" CJS credit company and "Aniv Ltd" universal credit company. During 2008, the number of credit organizations' branches grew by 8. As of December 12, 2008, there were 25 credit organizations operating in Armenia (with 48 branches), of which 4 leasing companies, one leasing union and 20 universal credit companies.

Assets of credit organizations, unlike the banking system, continued to grow at a progressive rate. While the average loan interest rates offered by credit organizations were somewhat higher than in the banking system, a large portion of the population still prefers to borrow money from credit organizations, considering that lending services provided by credit organizations are more affordable. Credit organizations provide loans nearly to all sectors of economy.

Over 2008, total assets of credit organizations grew by 51.8 percent (22.3 billion drams) and totaled 65.2 billion drams, or 6.4 percent of the banking system assets (compared to 5.6 percent at the beginning of the year). 86.7 percent of the asset growth was directed to lending and leasing. Credit investments (including leasing) grew by 51 percent and totaled 57.8 billion drams. Credit organizations increased lending to all the sectors of economy. Lending to industry grew by 36 percent (1.6 billion dram growth), agriculture by 109 percent (4.2 billion drams), construction by 258 percent (4.9 billion drams), transport and communications by 76 percent (1.2 billion drams), trade by 33 percent (2.4 billion drams), public catering and other service sectors by 30 percent (0.3 billion drams). Consumer and mortgage loans grew by 18 percent (1.3 billion drams) and 51 percent (2.3 billion drams) respectively. The share of lending in construction grew as a result of the construction sector rapid growth.

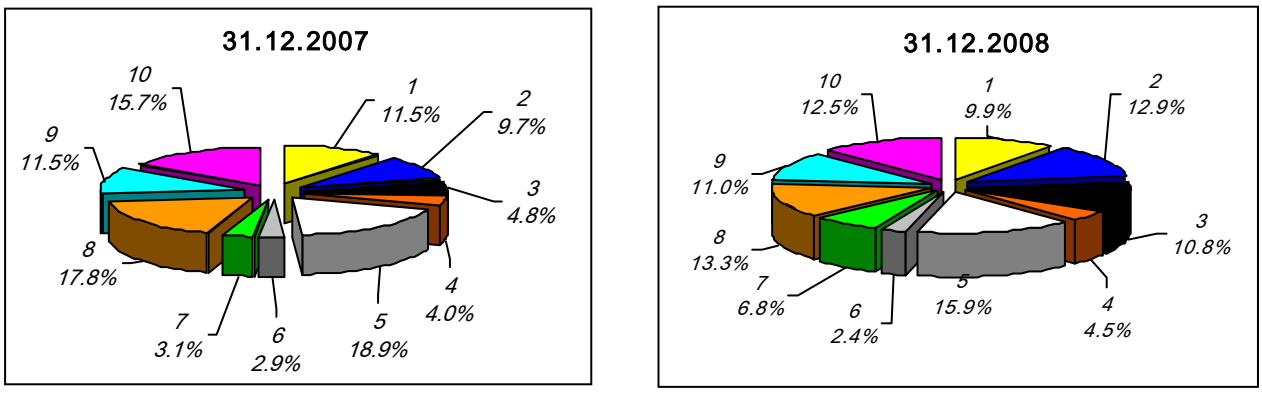
The share of non-performing loans of credit organizations ("watched", "sub-standard" and "doubtful" loans) grew by 1.9 percentage points and at the end of the year reached 4.0 percent. The share of non-performing loans within the sectors of economy is large in the sector of transport and communications (11.2 percent of the loans are non-performing), and industry (7 percent of loans are non-performing). The share of non-performing loans is small in construction and agricultural sectors, totaling 1.1 and 2.1 percent respectively.

During 2008, total capital of credit organizations grew by 45.6 percent (5.6 billion dram growth). The growth of the capital was due to the profit derived in the current year and growth of paid-up statutory capital. During the year, four newly-licensed and 6 existing credit organizations increased paid up capital by 3.2 billion drams in total. Retained profit of credit organizations in 2008 totaled 3.0 billion drams, return on assets was 5.5 percent, and return on capital was 19.8 percent. At the end of

[15] *Data for 24 credit organizations is presented, since the universal credit company "Aniv Ltd." received registration license on 27.12.2008.*

the year, capital totaled 17.8 billion drams or 7.6 percent of the banking sector capital (compared to 7.2 percent at the beginning of the year).

Chart 17. Credit organizations' Structure of Loans and Receivables to residents by sectors of economy



1. Industry, 2. Agriculture, 3. Construction, 4. Transport and Communications, 5. Trade, 6. Public catering and other public services, 7. Financial sector, 8. Consumer loans, 9. Mortgage loans, 10. Other

Liabilities grew by 54.3 percent (16.7 billion dram growth) and totaled 47.4 billion drams. Major sources for the liability growth were the claims of banks and other financial institutions, 7.6 and 5.8 billion drams respectively.

Borrowings from banks (almost entirely non-resident) and other financial institutions at the end of the year totaled 32.1 billion drams. Borrowings from legal entities and natural persons totaled 10.9 billion drams.

INSURANCE COMPANIES

GENERAL PROVISIONS

Insurance companies operating in Armenia

As of 31.12.2008, 11 insurance companies (with 5 branches) and 5 insurance mediators operated in Armenia. Over the year, the license of "First Insurance" LLC was revoked. Non-life insurance licenses were provided to "Alfa-Insurance" and "Rosgosstrakh-Armenia" CJS insurance companies.

Concentration in the insurance system

Herfindahl-Hirschman concentration index of the insurance system fell in 2008 (excluding concentration in liabilities).

Table 5. Herfindahl-Hirschman Concentration Index

Indicators	31.12.2006	31.12.2007	31.12.2008
Assets	0.08	0.12	0.10
Liabilities	0.07	0.10	0.14
Capital	0.16	0.18	0.10
Insurance premiums	0.13	0.17	0.15

Compared to end-2007, polarization between insurance companies at the end of 2008 was higher. The level of polarization grew both in terms of the 3 largest and the 7 largest insurance companies.

Table 6. Insurance System Concentration Level (%)

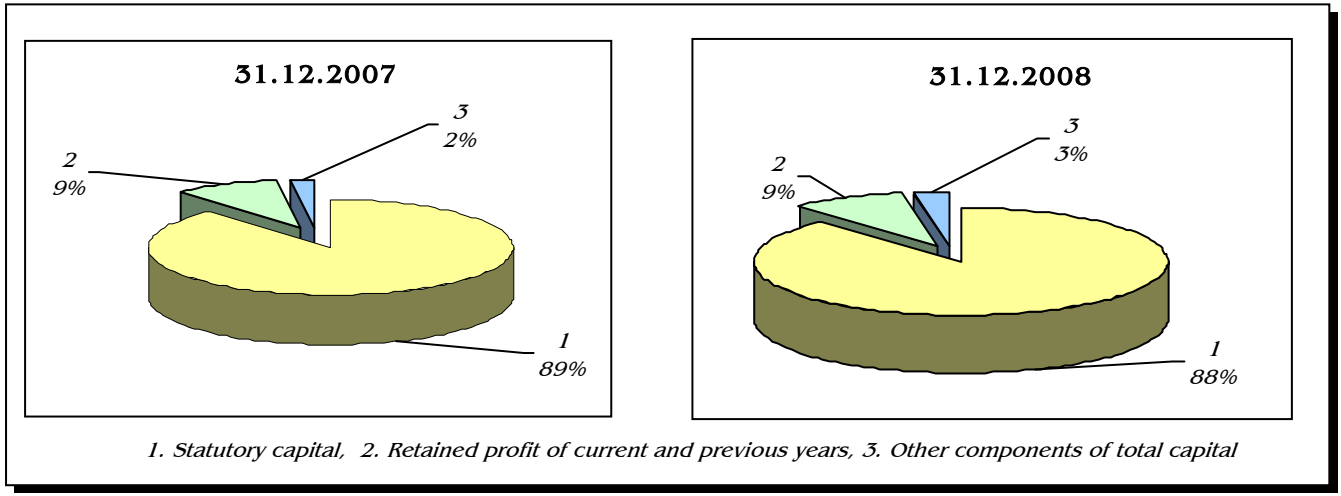
Indicators	31.12.2006	31.12.2007	31.12.2008
Assets			
CC 3 (the share of assets of **three** largest insurance companies within insurance system total assets)	36	45	38
CC 7 (the share of assets of **seven** largest insurance companies within insurance system total assets)	64	82	75
Liabilities			
CC 3	58	60	51
CC 7	87	96	87
Capital			
CC 3	28	37	31
CC 7	57	67	68

Insurance Premiums			
CC 3	52	63	54
CC 7	80	95	93

INSURANCE SYSTEM CAPITAL

In 2008, capital of insurance companies grew by 40 percent (2.1 billion drams) and totaled 7.5 billion drams. The growth was mainly driven by the entrance of two new companies into the market. Statutory capital grew by 43 percent (2.0 billion drams) and totaled 6.6 billion drams.

Chart 18. Structure of Insurance Companies Total Capital



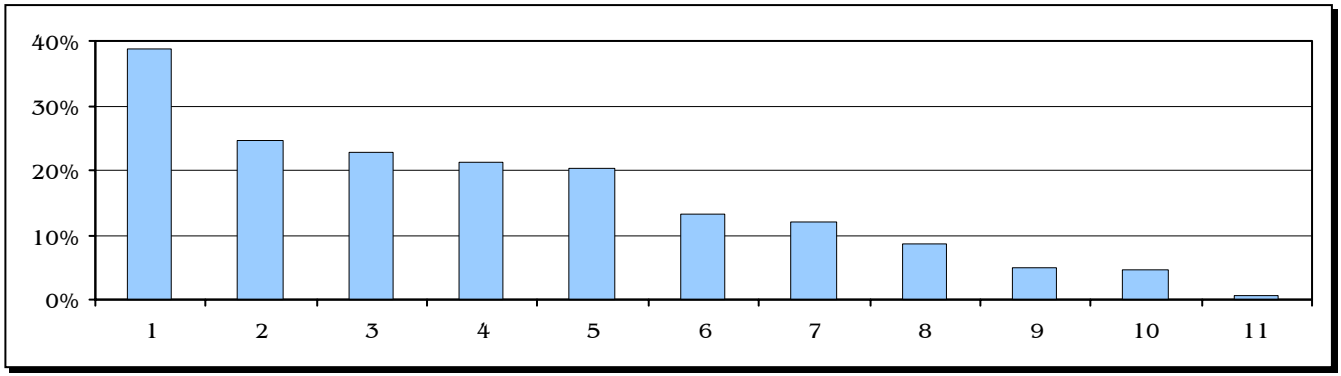
1. Statutory capital, 2. Retained profit of current and previous years, 3. Other components of total capital

Insurance Companies Solvency

The prudential standard indicator for solvency as of end-2008 was 14.7 percent, meaning that if the insurance system collects approximately 7 times more insurance premiums, other things being equal, 100 percent of the solvency limit will not be violated. Such a high level of solvency is an evidence of the system reliability, however, on the other side, it implies that insurance companies do not fully use their potential.

5 insurance companies had solvency limit within 20-39 percent range, while another six within 1-13 percent, which indicates that insurance companies have high solvency.

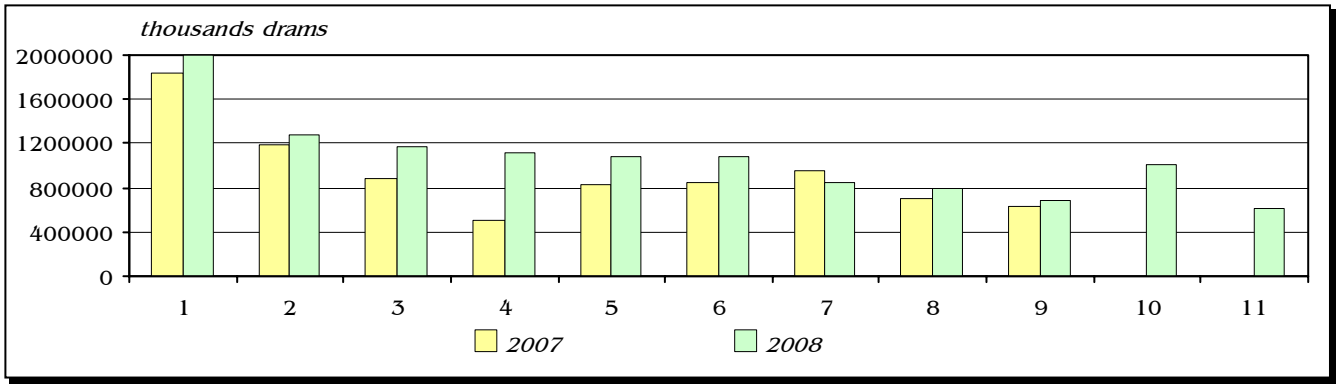
Chart 19. Required Solvency Limit to Total Capital Ratio[16] by Insurance Companies for 2008



INSURANCE SYSTEM ASSETS

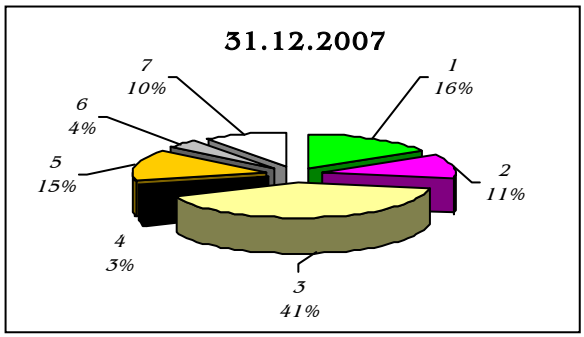
In 2008, the assets of the insurance companies grew by 40 percent and by end-December 2008 totaled 11.7 billion drams.

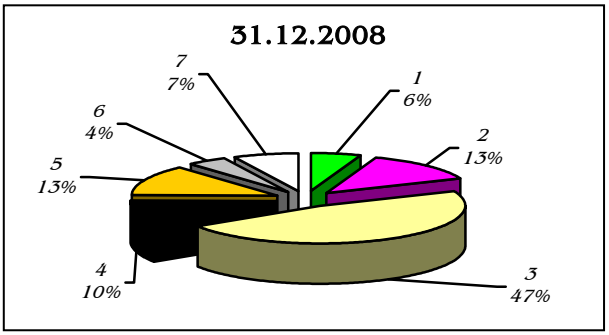
Chart 20. Insurance Companies Assets in 2008



[16] *The solvency margin of all insurance companies was equal to the solvency margin calculated by insurance premiums methodology.*

Chart 21. Structure of Insurance Companies Total Assets





1. Cash and banking accounts, 2. Receivable insurance premiums,
3. Current deposits and other investments, 4. Non-current deposits and other investments,
5. Securities, 6. Property and equipment, 7. Other assets

Nearly in all insurance companies (except one) total assets increased.

The structure of insurance companies' assets did not change significantly. By end-2008, the highest share was that of receivables on insurance premiums (13.1 percent), deposits and other investments 56.5 percent and government securities (9.1 percent).

The share of deposits and other investments within total assets grew, while the share of banking accounts fell.

Armenian insurance companies prefer to keep highly liquid assets, hence they do not face any problems in terms of compliance with the liquidity prudential standard.

INSURANCE SYSTEM LIABILITIES

In 2008, liabilities of insurance companies grew by 39 percent and by end-year totaled 4.2 billion drams. The growth was mainly driven by the growth of insurance reserves (31 percent) and amounts payable to co-insurers and reinsurers (45 percent).

Total liabilities of all the insurance companies grew, with the exception of one company.

In terms of the structure, assets and liabilities did not change significantly. At end-2008, the share of insurance reserves within total liabilities was 87.5 percent and the share of payables to reinsurers in terms of reinsurance premiums 36.8 percent.

Chart 22. Liabilities of Insurance Companies in 2008

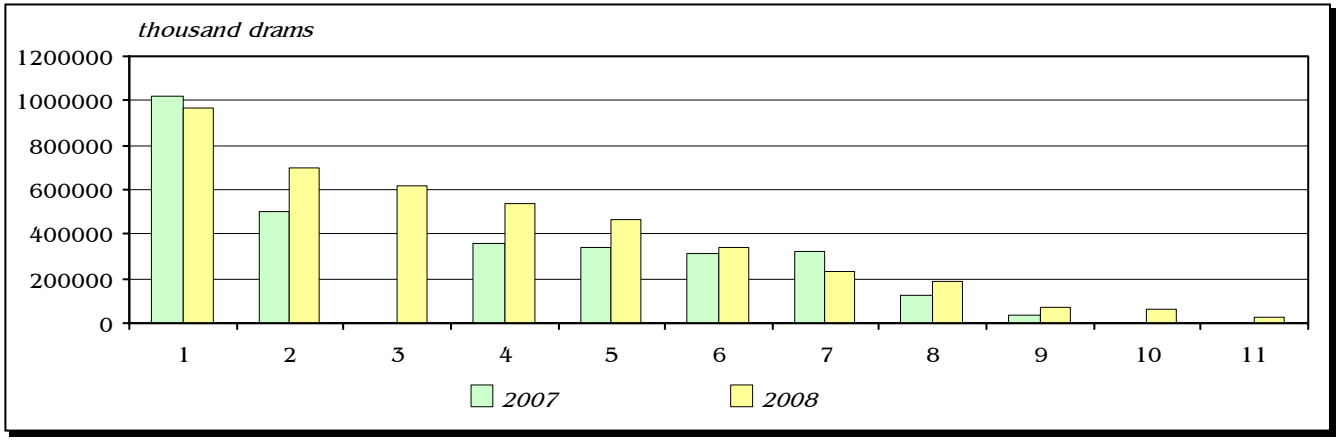
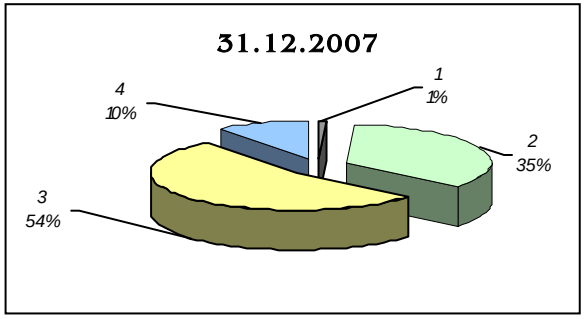
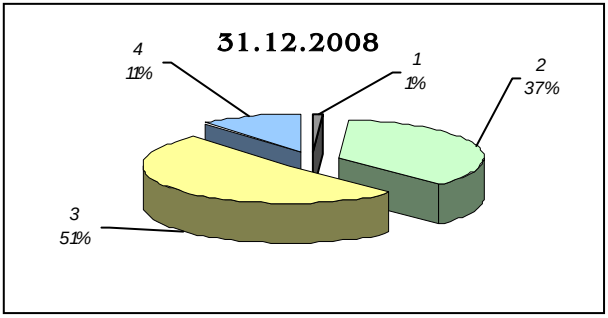


Chart 23. The Structure of Insurance System Total Liabilities





1. Payables on Insurance indemnity, 2. Payables to coinsurers and reinsurers, 3. Insurance reserves, 4. Other liabilities

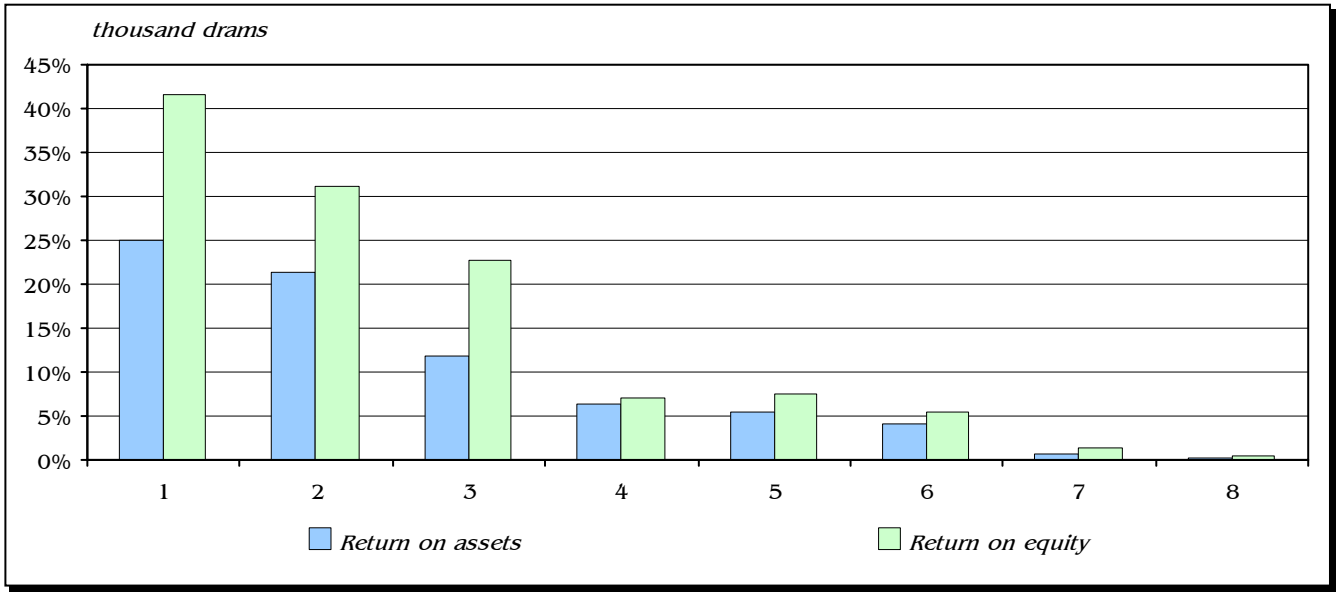
INSURANCE SYSTEM FINANCIAL PERFORMANCE

In 2008, net profit of the insurance system totaled 720 million drams, particularly 8 insurance companies worked with profit and 3 with loss.

Insurance companies return on equity (net profit to average total capital[17]) was 11.2 percent, while return on assets (net profit to average total assets[18]) was 7.2 percent.

In 2008, insurance premiums accrued by insurance companies totaled 7.8 billion drams (compared to 5.0 billion drams in 2007). Payables to reinsurers on reinsurance premiums totaled 4.0 billion drams, or 51.1 percent of insurance premiums (compared to 40.2 percent in 2007).

Chart 24. 2008 Yield of 8 Profitable Insurance Companies

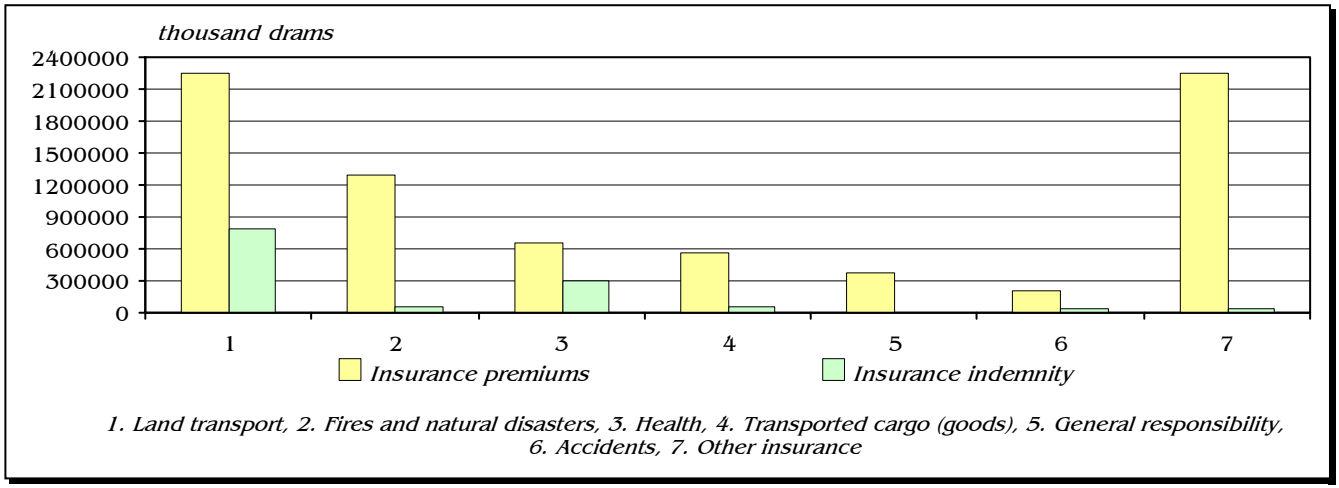


By end-December 2008, the insurance companies had 49.6 thousand insurance contracts in force. This was by 8.5 thousand contracts more than at end-December 2007.

As of end-December 2008, the sums insured under the insurance contracts in force totaled 2.3 trillion drams. However, the insurance companies transfer major part of their risks to reinsurers, hence the share of reinsurers within total sums insured was 88 percent. Huge reinsurance leads to the transfer and diversification of the insurance companies risks, which alleviates their indemnity burden in case of accidents insured. The insurance companies mainly cooperate with reinsurance companies which have high rating. Subsequently the risk that reinsurers may fail to fulfill their committmments is minimized.

[17] *The average total capital is calculated by dividing the sum of capital at the beginning and at the end of the year by two.*
[18] *The average total assets are calculated by dividing the sum of assets at the beginning and at the end of the year by two.*

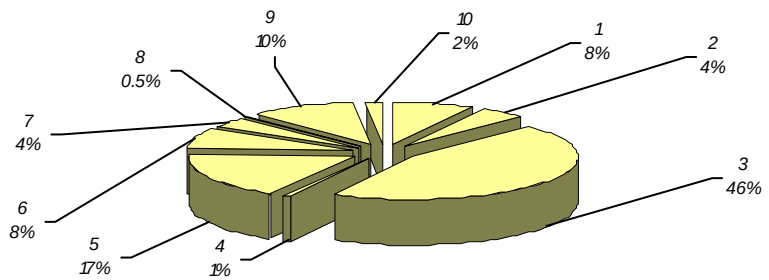
Chart 25. 2008 Accrued Insurance Premiums and Actually Paid Insurance Indemnity by Type of Insurance



1. Land transport, 2. Fires and natural disasters, 3. Health, 4. Transported cargo (goods), 5. General responsibility, 6. Accidents, 7. Other insurance

In 2008, loss ratio[19] of the insurance system totaled 17.7 percent (compared to 37.6 percent in 2007).

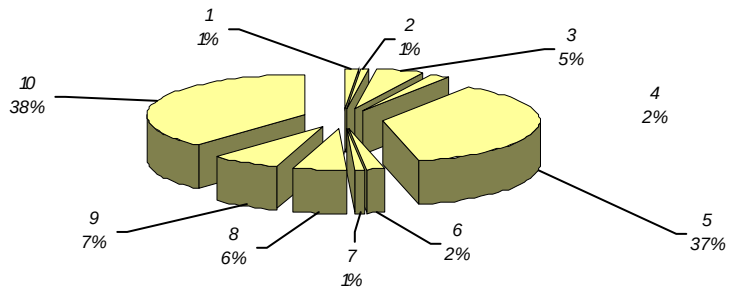
Chart 26 . The Strucuture of Insurance Contracts in Force as of 31.12.2008.



1. Accident, 2. Sickness, 3. Land vehicles, 4. Goods in transit, 5. Fire and natural disasters, 6. Other damage to property, 7. Motor vehicle liability, 8. General liability, 9. Assistance, 10. Other classes of insurance

[19] *Loss ratio was calculated as a relation of accrued insurance indemnity to earned insurance premiums in the reporting year.*

Chart 27. Strucuture of Sums Insured as of 31.12.2008



1. Accident, 2. Sickness, 3. Land vehicles, 4. Goods in transit, 5. Fire and natural disasters, 6. Other damage to property, 7. Motor vehicle liability, 8. General liability, 9. Assistance, 10. Other classes of insurance

Net interest income of insurance companies totaled 565.9 million drams, of which 66 percent was the share of interest income on current deposits in banks and borrowings.

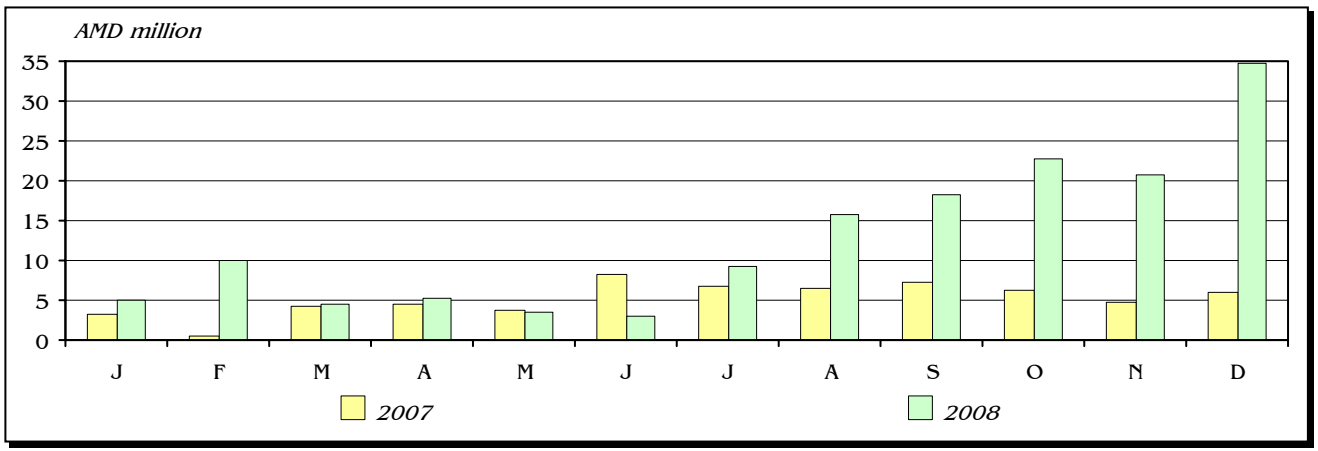
SECURITIES MARKET PARTICIPANTS

Compared to the same period of the previous year, at the end of 2008 the number of investment companies, carrying out securities transactions, or transactions on behalf of themselves, or customers' behalf and account, fell by 5 and totaled 10. In addition, nine of the investment companies are authorized for accepting and further messaging of customer instructions about securities transactions, six companies can carry out consulting services covering investment in securities, six companies are authorized to carry out securities allocations, five companies carry out securities portfolio management and four companies are allowed to operate as custodies. Beginning from February 29, 2008, 22 commercial banks have also become participants of the securities market, authorized to provide investment services without an additional license.

Due to the decline in number of investments companies, as of December 31, 2008, investment companies' assets decreased by 11 percent compared to the same period of the previous year, and totaled AMD 7.7 billion, while ownership capital grew by 29 percent and totaled AMD 2.7 billion. During the year, total profit of investment companies reached 16 million drams. Seven companies worked with profit, while 3 companies finished the year with loss.

Compared to 2007, Armenian securities market turnover in 2009 surged - the total value of transactions conducted in the securities market grew by 147 percent and totaled AMD 821.0 billion.

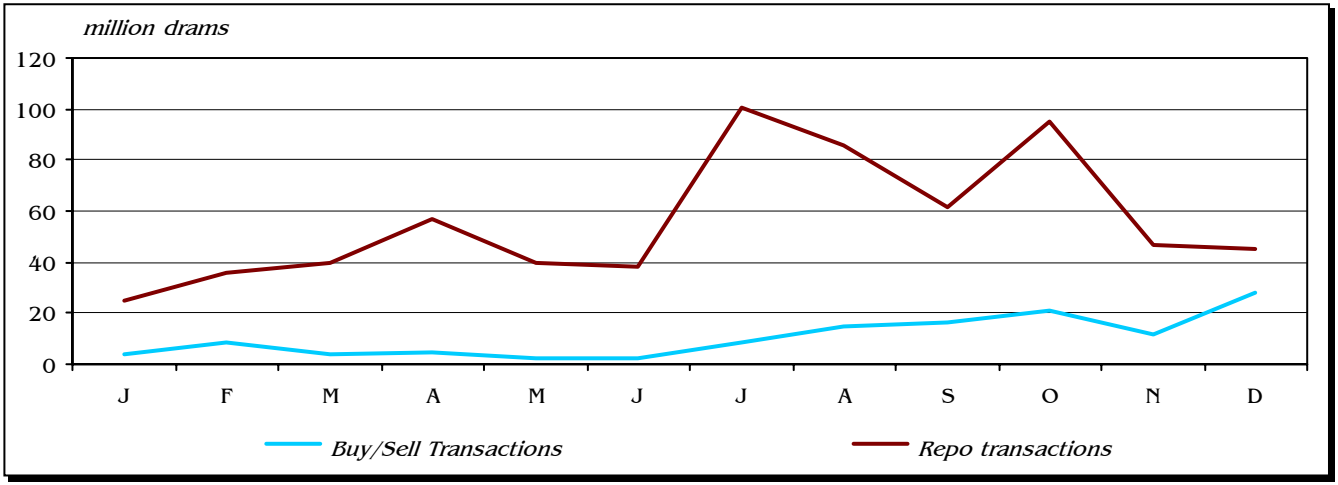
Chart 28. Securities Transactions Conducted by Providers of Investment Services by Months



Transactions with government securities still have the major share among transactions conducted by investment providers in securities market,. The share of transactions with government securities (including REPO transactions) was equal to 96.8 percent, or AMD 794.5 billion, growing against the

previous year by 144 percent. In 2008, the share of REPO transactions conducted by investment providers within total transactions with government securities slightly grew (by 1.4 percentage points) and totaled 84.2 percent.

Chart 29. 2008 Buy/Sell Transactions with Government Securities and REPO Operations Conducted by Investment Providers



Compared to 2007, transactions with corporate bonds in 2008 grew significantly, hence the volume of transactions with corporate bonds conducted within the framework of investment services grew by more than 3 times and totaled AMD 10.3 billion or 1.2 percent of the total turnover.

Transactions with shares grew by more than 6 times and totaled AMD 16.2 billion, or 2.0 percent of the total securities market turnover.

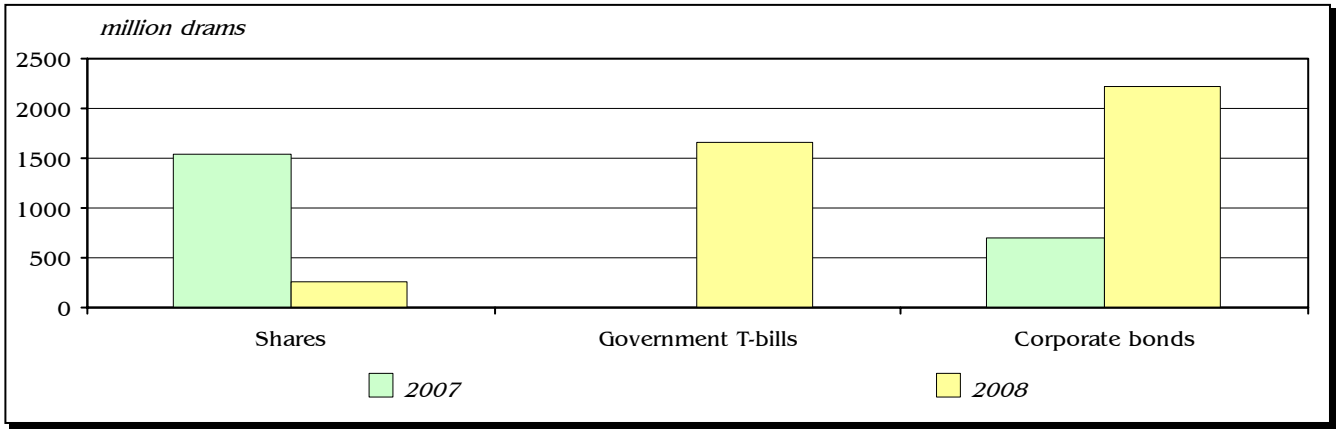
Compared to the previous year, REPO operations in securities market grew by 148 percent and totaled AMD 668.7 billion, or 81.5 percent of the total securities market turnover.

The share of over-the-counter transactions within total transactions carried out by investment providers decreased by 0.3 percentage points and, compared to the previous year, totaled 99.0 percent.

Securities transactions conducted in regulated market[20] in 2008 grew by 84.9 percent and totaled AMD 4.1 billion. Within such transactions, the major part in 2008 were transactions with corporate bonds, totaling 53.6 percent of the total regulated market turnover.

[20] *As of 31.12.2008, the only registered and licensed stock exchange in Armenia is NASDAQ-OMX Armenia OJSC.*

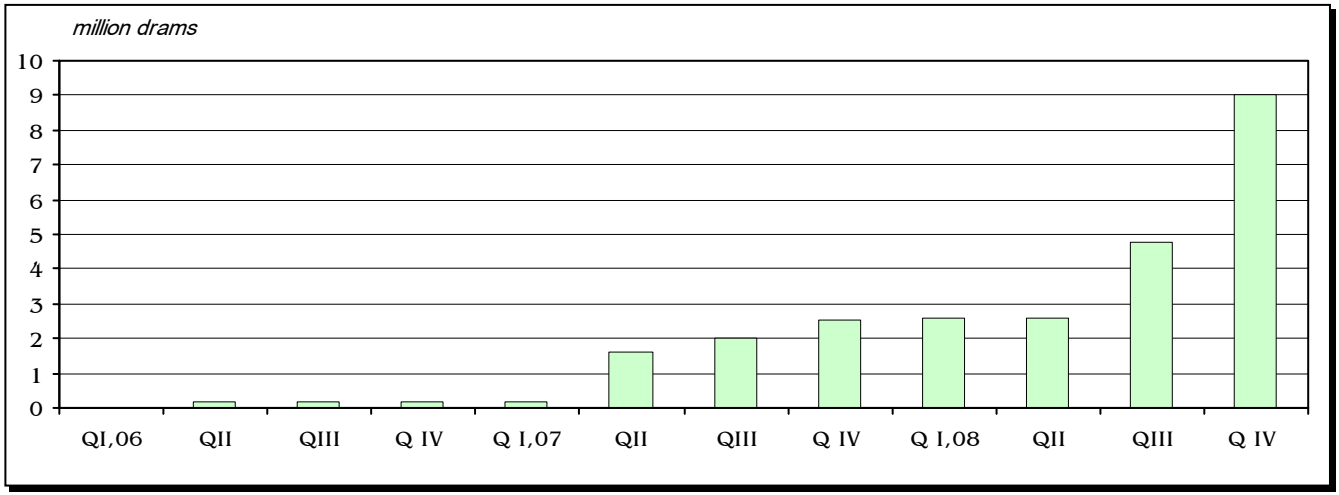
Chart 30. Structure of the Stock Exchange Turnover



As of December 31, 2008, the volume of resources attracted by investment providers within securities portfolio management grew by 78 percent compared to the same period of the previous year and totaled AMD 1.6 billion.

16 reporting issuers listed their securities in stock exchange. Four of the reporting issuers were banks and 1was an investment company. Nine of the reporting issuers issued shares, while eight issued bonds.

Chart 31. 2006-2008 Outstanding Corporate Bonds



As of end-2008, there were 1,202 register running issuers in the Central Depository and 128,329 holders of nominal securities the Central Depository.

Issues of corporate debt securities grew in 2008 - 13 corporate debt securities were issued with total value of AMD 11.4 billion, by 3.6 times more that the total volume of issuance in the previous year.

Within the registered Prospectus, 10 were on debt securities with AMD 7.7 billion dram total value, and 2 were on equity securities with AMD 3.6 billion value.

Within corporate securities issued in 2008, 36 percent were issued by financial institutions, 21 percent by the construction sector and 19 percent by the trade sector.

As of end-December 2008, 16 reporting issuers were operating in market, including 9 for shares and 8 for debt securities. OJSC "Ararat Bank" is a reporting issuer on both equity and debt securities.

PAWN SHOPS

As of end-December 2008, 68 pawn shops operated in Armenia. During 2008, 10 companies and entrepreneurs were granted with the pawn shop activities licenses while licenses of three pawn shops were revoked. During the year, total pawn shop assets grew by 50 percent, and loans provided by pawn shops grew by 62 percent. As of end-December 2008, the total assets of pawn shops totaled 4.8 billion drams, liabilities 3.2 billion drams, total loans provided by pawn shops – 3.9 billion drams.

EXCHANGE OFFICES AND DEALERS

As of end-December 2008, 246 exchange offices (excluding branches of banks) had licenses for currency trade operations. During 2008, licenses of 25 exchange offices were repudiated. 23 exchange offices were granted with currency trade license. During 2008, the volumes of the US dollar trade totaled US$ 363.7 million and US$ 358.1 million respectively(compared to US$ 449.7 million and US$ 443.6 in 2007). During 2008, the volumes of the Euro trade totaled Euro 38.7 million and US$ 37.9 million, respectively (compared to Euro 35.4 million and Euro 34.8 million in 2007).

During 2008, total foreign exchange buy operations of foreign exchange dealers totaled US$ 38.2 million, and sell operations US$ 42.4 million (compared to US$ 30.3 million buy and US$ 30.5 million sell in 2007). During the year, licenses of companies "Proffinance", "Capital Asset Management" and "Tonton" were revoked. As of end-December 2008, 2 legal persons had the license for foreign exchange dealer operations.

CLEARING COMPANIES

As of end-December 2008, 12 clearing companies operated in Armenia. Among them, 5 companies had the license only for money transfer operations, 6 companies had licenses for money transfer, payment instruments and processing and clearing of payment documents, and one company had a license solely for payment instruments and processing and clearing of payment documents. During 2008, 4 clearing companies were granted with license.

5 companies that have licenses only for money transfer operations (among them the JSC "GlobPayments" was licensed in 2008) mainly deal with remittances sent from abroad to Armenia through their transfer by international money transfer systems. In 2008, these companies executed payment of 6.8 billion drams to their clients (by 24.8 percent less than in 2007). Within this amount incoming remittances executed through international money transfer systems totaled 3.5 billion drams, while the outgoing remittances totaled 0.4 billion drams.

The share of companies executing money transfers within total international transfers (including commercial banks) totaled 0.1 percent of transfers to abroad and 0.8 Percent of the transfers received from abroad.

The average size of payment to single client through such transfers was 188 thousand drams. Within it, the average size of single payment through money transfer systems was 100 thousand drams (nearly the same as in the previous year).

Companies dealing with processing and clearing payment instruments and executing money transfers collect payments on consumption of public utility services from the automatic direct input terminals (three such companies "OSMP", "M-G-Pay System" and "Kvadracom" received the license in 2008).

Companies dealing with processing and clearing of payment instruments and executing money transfers collect consumer payments on public utility services from the automatic direct input terminals (telephone, gas, water, electricity) and on other services (internet, interactive television, loan repayment, etc.).

In 2008, clearing companies installed 357 direct input terminals, bringing the total to 553. Teller from these terminals in 2008 totaled 2,779 billion drams (879,403 operations) (8.9 times more than in the previous year).

In 2008, clearing companies started to render processing services to 3 commercial banks. In particular, based on the respective agreements, the three commercial banks performed 6,667 collections of dram 34 million payments for public utility services, while the processing of these cases was done by the clearing companies.

The processing center "ArCa", being the main operator of the unified system of payments with "ArCA" cards, services operations with "ArCA" cards, as well as "Visa" and "Master Card" international

card systems. During 2008, the processing center "ArCa" performed 259 billion drams processing of card operations (by 53.4 percent more than in the previous year), including 14 billion drams for cards issued by foreign banks (the same level as in the previous year), while the amount of operations with cards issued by the Armenian and processed through processing centers of the other Armenian banks (including foreign banks) totaled 27 billion drams, and grew by 38 percent (or by 7 billion drams). The amount of operations processed through Internet grew by 2.7 times and totaled 2.3 billion drams.

PAYMENT AND SETTLEMENT SYSTEM

Within the issues of payment and settlement system development, the CBA in 2008 continued works on payment and settlement system control and regulation of securities market, as well as development of non-cash payments and regulation of the legislative field.

Development of non-cash payments

Introduction of up-to-date technologies in financial market necessitates rendering of new payment services and development of new payment instruments. On one side, these reforms are conditioned by the broadening of services rendered to customers and favorable competition environment, while on the other, by the development trends of companies rendering communication services and informational technologies. In 2008, the CBA worked out a number of documents introducing general principles of issuance and servicing of "electronic money", principles of providing "mobile-banking" and "internet-banking" services aimed at the disclosure and management of possible risks on the one hand and at the formation of favorable conditions for provision of those services on the other.

Within the framework of pension reforms in Armenia and in coordination with the Ministry of Labor and Social Affairs, works were carried out on ensuring non-cash payments of pension benefits.

In light of the fact that the development of non-cash payments systems is directly associated with the introduction of card business and expansion of the scope of the rendered services, as well as given the sharp growth of card transactions (see the Chapter "Payment cards") in 2008, works were carried out within the "ArCA" unified card payment system on upgrading technical and software operational features of automatic teller machines.

During this period, a draft law on "Amendments to Payment and Settlement System and Payment and Settlement Organizations, Law" was designed, streamlining the legislative framework of the payment and settlement companies' activities. The law defined provisions on minimal total capital, delivery of payments and creation of payment and settlement unions and streamlined procedures on licensing of payment and settlement organizations and participation in payment systems.

12 Armenian commercial banks and 15 payment and settlement organizations were authorized by the CBA decisions to participate in various international payment systems. According to the СИФ legal acts, a number of commercial banks and payment and settlement organizations operating in Armenia have been granted permissions to become members of international payment systems, including 12 permissions granted to commercial banks and 15 – to payment and settlement organizations.

Enhancement of Securities Settlements

With the view to developing securities market, procedures on transactions with corporate securities in stock exchange were developed within the framework of works on automation of the Central Depository operations. In particular, they included agreement "On Preliminary Deposition and Settlement of Transactions with Corporate Securities in "NASDAQ-OMX Armenia" Stock Exchange", streamlining procedures on cash preliminary depositing and clearing and settlement of operations with the securities. In addition, the Central Depository regulation "On Securities Settlement System" was issued.

The CBA, in line with agreed plan with "NASDAQ-OMX Armenia, drafted concept papers "On Settlement Without Preliminary Depositing of Stock Exchange Transactions", and "Guarantee Fund for Settlement Without Preliminary Depositing of Stock Exchange Transactions", and shared them with the stakeholders for discussion. It is expected that the final outcome of these works will be a new procedure on execution and final settlement of stock exchange transactions, according to which participants will be able to conduct transactions in stock exchange without preliminary deposition of resources.

Basic Indicators of the Payment and Settlement System

In 2008, regular growth of the payment and settlement system continued, as evidenced by the respective indicators describing performance of the clearing system.

From the non-cash payments development point of view, the enrolment of population in the banking system is important. At the yearend 2008, the number of the banking system customers grew by 8.7 percent and totaled 1,015 thousand, among which individuals totaled 964 thousand. The number of their accounts grew to 1,385 (of which, 1,068 thousand current accounts, 61 thousand time deposits and 256 thousand credit accounts).

In 2008, 6,586,134 transactions were conducted with payment cards of AMD 326.4 billion. The value of payments by cards totaled AMD 25.8 billion. Within transactions with payment cards, Internet payments totaled 2.2 billion drams (of which, electronic commerce 912 million drams and card-to-card transfers 1.3 billion drams). As of yearend 2008, total number of cards in circulation was 454,357, or by 38.6 percent (126,505 cards) more than at yearend 2007. The volume of non-cash payments by cards (including operations through Internet) totaled around 8 percent of the total card operations. The total value of cashless operations with cards grew by 52 percent.

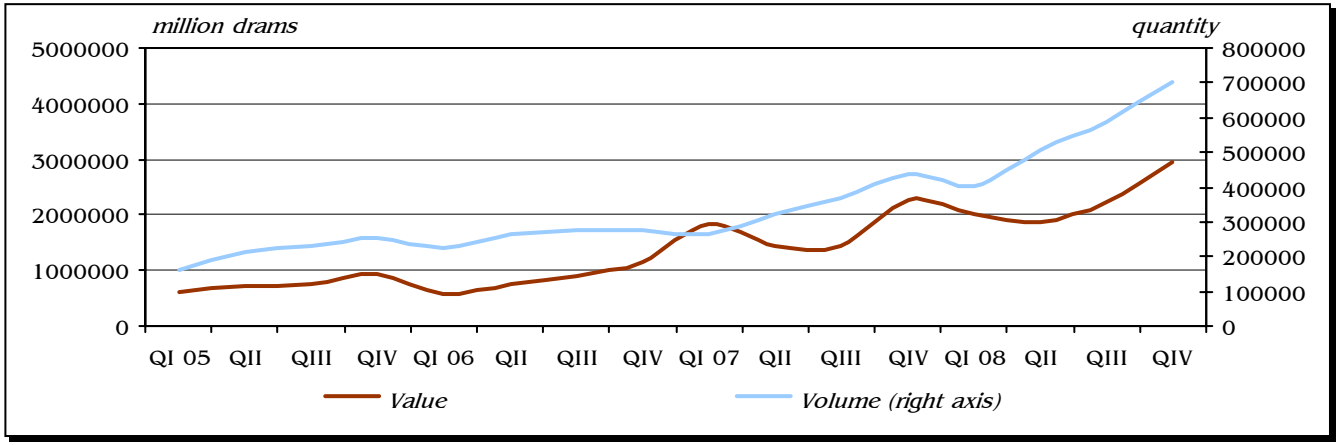
Compared to 2007, money transfers to individuals by banks and remittance transfer organizations grew by 17 percent and totaled 701 billion drams, while the value of outgoing remittances remained at the same level and totaled 343 billion drams.

In 2008, the value of non-cash payments in Armenia totaled 15,135 billion drams (5,043,571 transactions). The share of daily average non-cash transfers within GDP was 1.5 percent (3,450 billion drams), or by 0.32 percentage points more than in the previous year. Transfers through the CBA payment systems totaled 9,086 billion drams (2,200,265 transactions). Compared to 2007, transfers

through the CBA payment systems grew by 30 percent (2,120 billion drams) in value and the quantity by 58 percent (806,879 transactions) in volume.

The daily average value of the transfers through the CBA payment systems (excluding transfers on stock exchange transactions) totaled around 35 billion drams (8,595 transfers). Compared to 2007, the daily average amount of the transfers grew by 8.2 billion drams (the number of transfers grew by 3,152). The daily average value of transactions through the CBA payment systems totaled 46 billion drams (6.5 times growth).

Chart 32. Volume and value of transfers executed by the CBA (excluding stock exchange transfers)



In 2008, the share of transactions from and to the Treasury within transfers executed by the CBA (excluding transfers on stock exchange transactions), remained high, totaling 38.88 percent of the value and 50.73 percent of the volume. Compared to 2007, the value of the Treasury transfers executed by the CBA grew by 8.4 percent (275 billion drams), and the volume by 73.78 percent (473,858 transfers).

CBA Payment Systems

Electronic payments system

As of end-2008, the total number of the CBA electronic payments system participants totaled 262, including the CBA and its 3 regional cash centers, the Treasury with 44 offices, 22 commercial banks

with 189 branches, the "Armenian Card" processing center, the Interstate Bank (Moscow), "NASDAQ-OMX Armenia" stock exchange, and one non-bank dealer.

The major part of payments executed through the CBA payment systems was done by the electronic payments system. The share of the value and volume of electronic payments within total constituted 53.5 percent and 95.7 percent, respectively. Compared to 2007, the volume and quantity of electronic payments within total grew by 24 percent (944 million drams) and 57 percent, respectively (763,205 transactions). Stock exchange transfers totaled 11,881 billion drams. Payments of the commercial banks through the electronic payments system (excluding transfers on the stock exchange transactions) totaled around 67 percent of their total transfers (826 billion drams increase), with the number of such transfers growing by 99 percent.

Compared to 2007, the average daily volume of transfers through electronic payments system grew by 2,981, and totaled 8,222, while the value grew by 3,686 million drams, totaling 18,984 million drams. The average daily value of electronic transfers on stock exchange transactions grew by 39 billion drams and totaled 46 billion drams. Compared to 2007, the average value per electronic transfer excluding transfers on stock exchange transactions fell by around 0.6 million drams and totaled 2.3 million drams. The average value of transfers of commercial banks' stock exchange transactions through electronic payments system totaled 862 million drams, growing by 636 million drams.

Chart 33. Average Daily Transfers Through Electronic Payments System

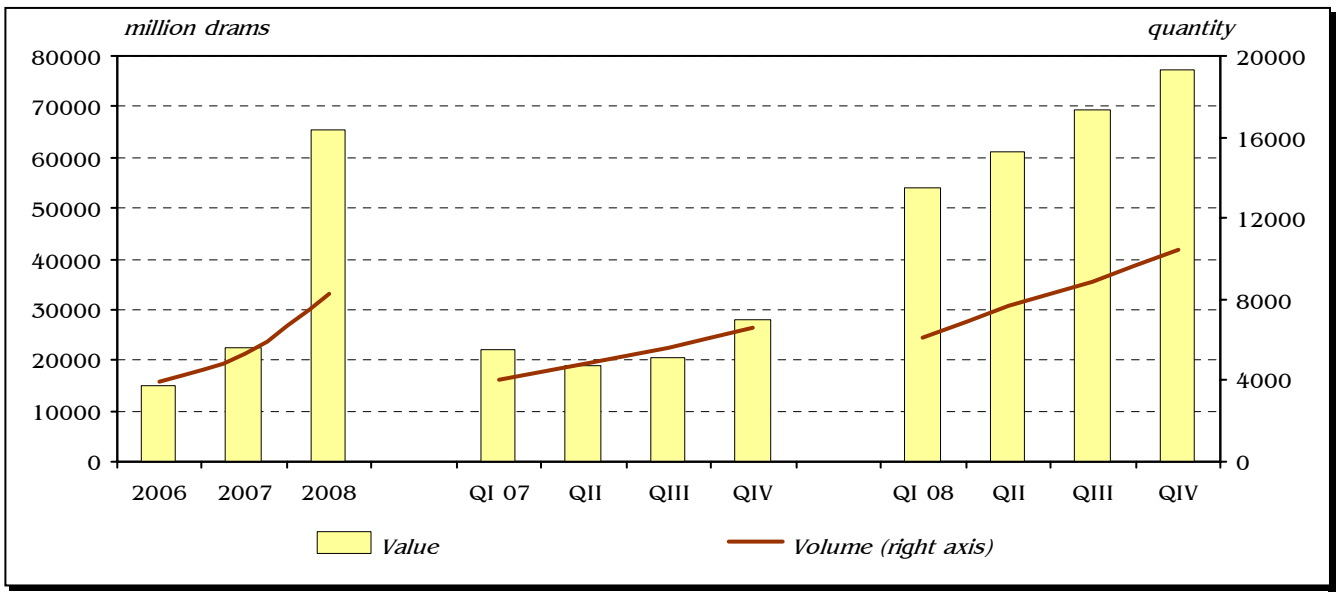
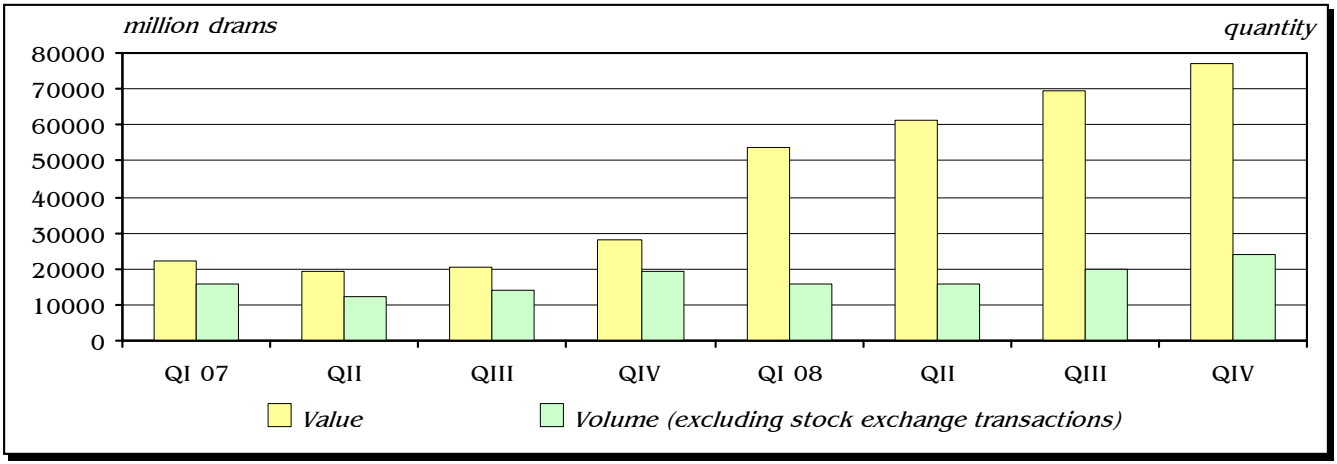


Chart 34. Electronic Payments System Transfers Related to Stock Exchange Transactions in Average Daily Payments



Paper-based Gross Settlement System

In 2008, paper-based payments of the commercial banks totaled 38.7 percent of the value and 4 percent of the volume of the total payments (compared to 2007, the value grew by 1.2 times and the volume by 2 times).

The average number of daily paper-based transfers processed by the CBA totaled 350 with AMD 13.7 billion value (compared to 2007, the average daily value grew by 5 billion drams), while the average value of one such transfer fell by 10 million drams compared to 2007, and totaled 39 million drams. Most of the paper transfers related to deposit and Repo operations and the Treasury transfers. In 2008, the commercial banks made 79 interbank paper-based transfers through the CBA with a total value of 45.9 billion drams (28.9 percent growth of value).

Table 7. CBA, Commercial Banks and Treasury Payments Processed by the CBA Payment Systems (in millions of drams)

Period	Gross				Government securities accounting and clearing system		Total through CBA		Transfers on Stock Exchange Transactions	
	Electronic *		Paper							
	Amount	Number	Amount	Number	Amount	Number	Amount	Number	Amount	Number
2007										
QI	3916236	1341687	2188204	44557	861365	7142	6965805	1393386	1821341	8075
Share in total payments (%)	56.22	96.29	31.41	3.20	12.37	0.51	100	100		

2008										
QI	1024878	389728	745062	12179	240876	1764	2010816	403671	2422627	3026
Share in total payments (%)	50.97	96.54	37.05	3.02	11.98	0.44	100	100		
QII	1022887	488017	691740	16625	163687	1495	1878314	506137	2886558	3236
Share in total payments (%)	54.46	96.42	36.83	3.29	8.71	0.29	100	100		
QIII	1275574	564371	798290	22434	172482	1376	2246326	588181	3172312	3683
Share in total payments (%)	56.78	95.95	35.54	3.8	7.68	0.23	100	100		
QIV	1536657	662776	1281886	38309	131764	1191	2950307	702276	3399058	3837
Share in total payments (%)	52.08	94.38	43.45	5.45	4.47	0.17	100	100		
Total	4859976	2104892	3516978	89547	708809	5826	9085763	2200265	11880556	13782
Share in total payments (%)	23.18	95.07	16.77	4.04	3.38	0.26	100	100		

** Excluding transfers on stock exchange transactions*

Government Securities Accounting and Settlement system

As of yearend 2008, members of the government securities accounting and settlement system were 5 agents and 17 dealer banks, Deposit Compensation Guarantee Fund, the Armenian Central Depository, "NASDAQ-OMX Armenia", stock exchange, one non-bank dealer, Ministry of Finance (as the issuer of government bonds), Treasury Direct, as well as the CBA (as the central custodian and the issuer of the CBA bills).

The system generated 2,222 orders of 109.6 billion drams for the primary placement and redemption of government treasury securities, which was by 7.6 billion drams more than in 2007 (payments on primary placement of securities increased by 11.9 billion drams, while redemptions fell to 4.2 billion drams). In 2008, banking transfers on purchasing of government securities at primary public placements totaled 64.5 billion drams, while Treasury's transfers on redemption of government securities totaled 45.1 billion drams, including 1.8 billion drams through the system "Treasury Direct", of which 1.1 billion drams for primary placement of securities and 0.7 billion drams for redemption.

The system generated 626 orders of 140.7 billion drams by government securities accounting and settlement system for the primary placement and redemption of the CBA bills. During the initial offering, commercial banks' transfers on purchasing the CBA bills totaled 52.6 billion drams, falling by 61 percent (82.2 billion drams), while transfers on CBA bills redemption totaled 88.1 billion, falling by 31 percent (38.7 billion drams).

Concentration in payment systems

Reflected by the increased electronic payments of the commercial banks, the level of concentration of payments in the CBA paper-based gross settlement system by yearend 2008 dropped significantly (by around 15 percent). Compared to the previous period, the level of concentration within payments through gross electronic payments system grew by 4 percent. The growth was driven by the progressive use of single payment orders of the banks.

While concentration of the payment card servicing fell (volume by 1 and value by 2%), still it is rather high (67 percent by volume and 69 percent by value is the share of 5 banks). Furthermore, 7 banks serviced 25 percent of payment cards. In 2008, these two groups of the banks were relatively active in payment card servicing, as they installed new equipment and broadened the network of trade and service outlets.

Table 8. Level of Concentration in Payment Systems (%)*

Type		2006		2007		2008	
		Value	Volume	Value	Volume	Value	Volume
Gross	Electronic	42	55	31	54	31	59
	Paper	43	2	32	3	17	2
Government securities accounting and settlement system		50	48	49	42	49	42
Card system	servicing	-	-	71	68	69	67

* *Indicators of the five largest banks by value and volume.*

PAYMENT CARDS

As of end-2008, 21 commercial banks provided payment cards to their clients and serviced them. 19 banks participate in the "ArCA" unified card payment system.

In 2008, 200 new automatic teller machines were installed, and subsequently their total number by end-year reached 538. Servicing of "ArCa" cards is rendered by 468 automatic teller machines. Commercial banks also operated 252 POS-terminals, bringing their total to 2,280, of which 410 are installed in the branches. The number of installed imprinters is 19.

Table 9. Servicing of Issued Cards

Indicator	International criteria	2006	2007	2008
Issued cards / ATM	2600	1162	970	942
Issued cards / POS	160	158	162	154

Table10. Types of Cards Issued/Serviced by Banks Operating in Armenia

Bank	ArCa	MASTER CARD	VISA	AMEX	Other
Armbusinessbank	+	+			
Anelik	+	+	+		
Ararat	+	+			
Ameria Bank	+	+	+		
VTB Bank Armenia	+		+		
Armeconombank	+	+			
Prometey	+	+			
BTA	+	+			
Armenian Development Bank	+	+			
Converse Bank	+		+		+
Inecobank	+	+			
Mellat	+				
Byblos Bank Armenia	+	+			
HSBC Bank Armenia	+	+	+		+
ACBA Credit-Agricole	+		+		
Artsakhbank	+	+			
Cascade	+	+			
Areximbank		+	+	+	
Unibank	+		+		
Ardshininvestbank	+	+	+		
Procreditbank			+		

Compared to 2007, the number of "ArCa" cards grew by 40.5 percent (57,708 cards) and totaled 200,190. The number of the international card system cards grew by 37.1 percent (68,797), of which: "Visa" 19.1 percent (26,614), totaling 165,894, "Master Card" 102 (24,104), totaling 47,769. The rest (18,079 cards) are other international cards.

The share of "ArCa" cards within total cards issued by banking system was 44.1 percent, "Visa" and "Master Card" 36.5 percent and 10.5 percent, respectively, the remaining 8.9 percent were other international cards, including "HSBC Debit" cards.

Compared to 2007, the value of card operations grew by 52.8 percent (112.7 billion drams), and the volume by 48.7 percent (2,157,584).

2,915,892 operations with "ArCA" cards totaled 117.5 billion drams. Compared to 2007, the volume of operations with "ArCA" cards grew by around 57 percent (42.6 billion drams), and the value by 40 percent (834,838). The value of operations with "ArCA" cards within total operations was equal to 36 percent and the volume 44 percent.

Within card operations, "Visa" international cards have the highest share of 38.9 percent.

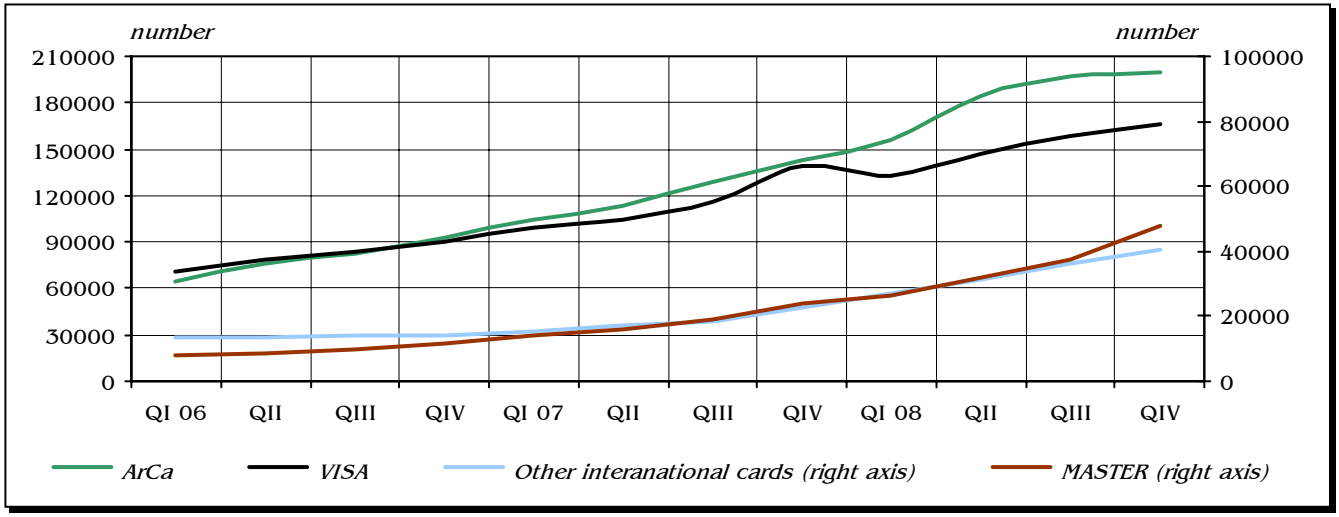
The value of operations with "Visa" cards totaled 127 billion drams (2,090,858 operations), "Master Card" 39 billion drams (653,957 operations). Compared to 2007, operations with "Visa" cards grew by around 40.9% percent (36.8 billion drams), and operations with "Master Card" by 96.8 percent (19 billion drams).

Operations with other international cards totaled 925,427 (42.5 billion drams), by 48.7 percent (13.9 billion drams) more than in 2007.

The average daily volume of card operations in 2008 grew by 52.7 percent and totaled 907 million drams (18,295 operations). The share of "Visa" international cards was 39 percent, and the share of "ArCA" cards 36 percent. Compared to 2007, the average number of daily operations grew by 48.7 percent (5,993).

In 2008, the average daily value of card transactions grew by 52.7 percent and totaled 907 million drams, the average daily volume of card transactions totaled 18,295, of which the share of "Visa" international cards was 39 percent, the share of "ArCA" cards 36%. Compared to 2007, the average daily number of transactions grew by 48.7 percent (5993).

Chart 35. Payment Cards Issued by Banks (growth flow)



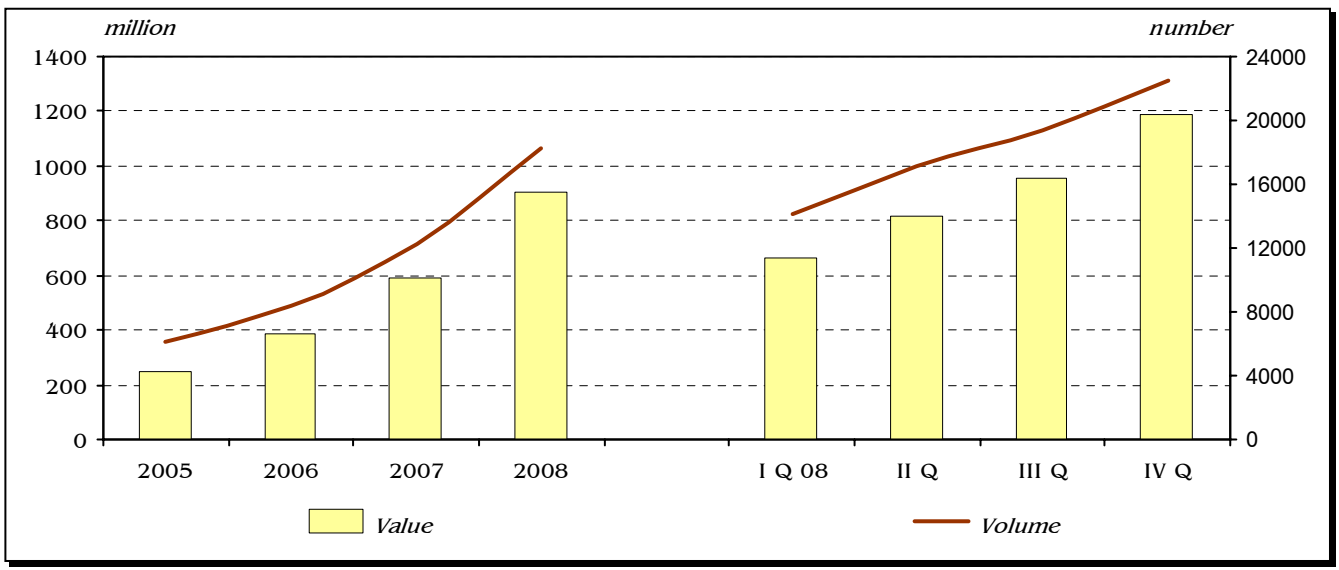
Compared to 2007, the average monthly operations with "ArCA" cards grew approximately by 3 thousand drams and totaled 53 thousand drams (quantity by 1.3).

Table 11. Transactions with card processing equipment (2008)

Equipment	Transactions			
	amount (million dram)	quantity	of which: ArCA cards	
			amount (million dram)	quantity
Automatic teller machines	245911	90985	5464992	2411888
o/w: non-cash	3206	228	85215	35304
POS–terminals/imprinters	78676	26094	1038957	473100
o/w: non-cash	20903	7509	553578	192210
Internet environment	1784	471	82185	30904
Total	326371	117550	6586134	2915892
o/w: non-cash	25893	8208	720978	258418

In 2008, average value of monthly transactions with one "ArCa" card grew by around 3 thousand drams, totaling 53,000 drams (volume equals to 1.3), compared to 2007.

Chart *36. Average daily payment card operations in 2005 – 2008 and by 2008 quarters*



INTERNATIONAL MONEY TRANSFER SYSTEMS

Remittances of individuals without opening of a banking account are executed by the commercial banks and money remittance organizations licensed by the CBA (see chapter Payment and Settlement Organizations).

To improve the process of transfers commercial banks operating in Armenia participate in 17 international money transfer systems (UNISTREAM, ANELIK, CONTACT, MIGOM, BISTRAYA POCHTA, etc.).

Table12. Money Transfer Systems

System	Number of participating banks	Number of other participating organizations	Share in payments received (%)
UNISTREAM	3		51.38
ANELIK	8	3	9.51
CONTACT	4	4	8.93
MIGOM	7	4	5.86
BISTRAYA POCHTA	6	2	5.67
MONEY GRAM	10	2	2.08
LIDER	5		2.33
INTEREXPRESS	2	2	1.71
ZOLOTAYA CORONA	2		0.84
BLIZKO	2	3	1.23
PRIVAT MONEY TRANSFER	3		0.81
BTF-Souz	1		1.36
FASTER	1	1	0.38
ALLUR	3		0.13
AVERS	2		0.01
XPRESS MONEY	1		-
JIVIE DENGI	1		-
WESTERN UNION*	-	-	7.33
MONEY TUN	-	1	0.03
Travelex	-	1	0.07
STEFI	-	1	0.33

** subscription was suspended in October 2008*

In 2008, transfers to Armenia through the banks (participating in these systems totaled 439.4 billion drams (1,636,683 transfers), or by 11.3 times more than transfers from Armenia to abroad. Subsequently, net money inflow through commercial banks totaled 400.5 billion drams, or 15 percent

(54 billion drams) more than in 2007. Compared to 2007, transfers to Armenia grew by 27 percent (53.6 billion drams). The value of an average transfer was 268 thousand drams, or by 16 thousand dram more than in 2007.

In 2008, transfers to Armenia through commercial bank correspondent accounts (processed by SWIFT, telex, or fax) totaled 2,295 billion drams (by 467 billion drams more than in 2007), (232,999 operations). The average amount of one transfer was 9.8 million drams, or 3.5 million dram more than in 2007.

Within transfers through commercial bank correspondent accounts, individuals' transfers from abroad to Armenia grew by 52 billion drams and totaled around 255 billion drams. The average volume of one such transfer grew by 222 thousand drams and totaled 2.38 million drams. At the same time, individuals' transfers through correspondent accounts transfers from Armenia grew by 0.4 billion drams, totaling 303 billion drams. Subsequently, the net outflow of household transfers within correspondent accounts of commercial banks totaled 49 billion drams, falling approximately twice compared to 2007.

SUPERVISION DEVELOPMENT OUTLOOKS

During the last 2 years, nearly all countries took multiple steps for overcoming current financial and economic crisis and mitigating its impact. Given the existing difficulties, financial community takes all efforts to enhance supervision and regulation in order to safeguard viability of the global financial system. Supervision bodies emphasize financial support to entities that have a vital systemic role in order to prevent collapse of the global financial system. The impact of the current global crisis was manifested in the Armenian financial system only in the last quarter of 2008.

In 2009, the CBA will proceed with the reforms to ensure sustainable development of the interbank system, securities and insurance markets, for ensuring stability and liquidity of the financial system, strengthening clearing systems and broadening financial intermediation.

Financial system regulation prospects

In 2009, the CBA will continue to develop and implement new anti-crisis measures and mitigate negative impacts of the global recession over the financial system.

In addition to regular risk assessments of separate financial entities, the CBA will continuously monitor developments in the overall financial system, and identify the risks and obstacles. Within the framework of measures on protection of the financial sustainability, the CBA will conduct a rigorous surveillance of the risks both in the financial and microeconomic sectors (real, fiscal and foreign trade sectors)[21]. The CBA designed various stress-scenarios in order to understand and assess risks of financial institutions during different crisis situations. These scenarios are regularly updated and modified. Furthermore, the CBA designed programs of response to extraordinary situations that clearly define the grounds for the use of the anti-crisis instruments and describe sequence of actions and responsibilities of each unit. In 2009, the CBA plans to conduct simulation games in order to foster orientation skills in crisis situations and help decision makers apply in practice crisis management skills, take quick decisions and implement urgent measures during emergency situations.

With the view to ensuring financial stability of the commercial banks, the new legislative amendments will broaden the CBA capacities for liquidity injection.

In 2009, a new system of banking risk assessment for a comprehensive risk scoring of banks will be introduced, based on analysis of the risks for each type of business operations, and assessment of the quality of risk management. The new system will improve business operations, and the quality of risk management by banks. The system will allow supervisors to focus on the core risk bearing

[21] A detailed description of the Armenian financial system sustainability is presented in "2008 Financial Sustainability Report" periodical.

business operations of the banks, as well as comprehensively assess risk management systems and perform detailed assessment of each type of risk. The new risk assessment system has the advantage of integrating various qualitative indicators for the final assessment of risks. After effective introduction of this system in banks, it can be also applied for the risk assessment of other financial institutions.

In 2009, the CBA will continue works on bringing the banking system accounting principles into compliance with the international standards.

Reflecting the high demand of economy for long-term crediting, the upsurge of bank mortgage lending continued in 2008. In 2009, the CBA will proceed with works on further development of the real estate market. The CBA has already designed and submitted to the government concept paper "On Creation and Operation of Mortgage Fund in Armenia". Creation of the mortgage fund will help to create efficient infrastructure for enhancing circulation of long money and using it as mortgage loans.

In 2009, activities of the securitization fund will be further regulated and promoted, with the view to supporting development of the secondary securities market in Armenia, solving the liquidity problems of the banks and credit companies, increasing the level of financial intermediation provided by banks and credit organizations, fostering mortgage lending and increasing the volume of "long money" in capital market.

Strengthening of the pension system will boost generation of durable resources for the economy, subsequent deepening of the financial system and improvement of the financial intermediation. In 2009, the CBA will continue active participation in works on the pension system reforms.

Starting from May 26, 2009, the law "On Circulation of Credit Information and Activities of Credit Bureaus" will enter into force. Subsequently, the by-laws regulating their activities will be modified (credit bureau licensing, criteria on availability of space, equipment, safety regulations and software, regulation of business procedures, reporting by credit bureaus).

The CBA is planning to proceed in 2009 with the reforms in the payment and settlement system regulatory framework. In particular, activities of organizations issuing "electronic money" will be regulated. In addition, it is planned to continue works on regulation and development of services rendered through "mobile-banking" and "internet-banking" technologies. These technologies allow the customers to administer banking accounts in "off-site" regime and enhance payments through banking transfers mainly for purpose of the collection of public utility fees, insurance premiums, budget transfers, etc.

In 2008, the National Assembly Standing Committee on Financial and Budget Issues reviewed the draft law "On Restriction of Cash Operations", designed in cooperation with the state administration agencies and amendments to other laws ensuing from it.

In 2009, the draft law should be submitted to the National Assembly. Purpose of the law is to enhance payments through banking transfers and to combat shadow economy. The law defines types of transactions and operations, which should be executed through banking transfers, i.e. payments from the banking account of the payer to the account of the beneficiary.

In 2009, the CBA will continue active cooperation with "NASDAQ-OMX Armenia" with the view to boosting capital market. The respective measures will be implemented in 3 directions:

1. Broadening of investment opportunities. Among the measures are the temporary tax privileges provided for IPOs and listings in the stock exchange, formation of favorable legislative field for the new issuers, steps aimed at improving the quality of the services rendered by the underwriters, etc.
2. Strengthening market infrastructures, such as trade and settlement systems (introduction of T+3 settlement system without preliminary depositing, etc.).
3. Measures to improve marketing and outreach with various market participants.

In 2009, works will continue on design of the various by-laws necessitated by the law "On Securities Market" and revision of the existing by-laws.

In 2009, the CBA plans to design legislation (laws and by-laws) regulating activities of the investment funds, with the view to developing such mechanisms, which will enable small investors to combine their resources and make diversified collective investments. Creation of legislation on investment funds would serve as a basis for the establishment of venture foundations, securitization fund, as well as for the managers and custodians of the pension funds.

Works on introduction of the infrastructure promoting the efficiency of insurance market will continue. These include the draft laws designed in 2008 and modified in 2009, as follows:

1. In 2008, the CBA drafted the law "On Compulsory Insurance of Responsibility on Use of Vehicles", endorsed by the government at the yearend. Presently the draft law is included into the National Assembly agenda for 2009.

2. The CBA will implement works on assessing the perspectives for the introduction of different compulsory insurance schemes in Armenia. The best practices of compulsory insurance include medical, general civil responsibility, professional responsibility for separate professions, accidents during production processes, and health insurance. In 2009, feasibility studies will be conducted on introduction of various compulsory insurance schemes and based on them the compulsory insurance strategy will be introduced in Armenia.

3. In 2008 informational system on customers of insurance and reinsurance companies was operated (insurance register), enabling insurance companies to obtain information on previous insurance policies signed by their customers, and efficiently calculate insurance premiums. The system will be further improved in 2009.

4. In cooperation with the Ministry of Health, the work on creation of a unified insurance data base will continue. The data base will incorporate information on health history of individuals and ensure its affordability to medical institutions, and in future – insurance companies.

Financial system supervision prospects

In 2009, the CBA will continue the process of replacing supervision by types of institutions (banks, insurance companies, participants of securities market, etc.) by a new supervision system. There will

be a clear distinction between prudential, market conduct and financial system consumers' interest protection regulations and supervision processes.

Measures on protection of consumer interests will be viewed as a priority and implemented in three directions.

1. Implement reforms of laws and by-laws on business conduct of financial companies, with the view to creating tools for the protection of consumer interests.

2. Improve financial literacy of population. Implement educational and outreach measures among target groups of population including students, teachers and representatives of the civil society. In future, the scope of the target groups will broaden.

3. Strengthen the CBA supervision capacities. Protect consumer interests, monitor and supervise business conduct of companies are introduce new functions for the CBA. Subsequently, new supervision manuals should be designed for effective, unified and consistent supervision of business conduct.

It is planned to significantly improve the existing consolidated supervision processes and introduce new principles of supervision of the Armenian financial system. This will be done with the view to improving the overall coordination of supervisory activities on analysis of financial groups' structures, assessment their capital adequacy and identification of impacts of joint operations on financial performance.

In 2009, the CBA will develop new instruments for quick response to performance deterioration of investment and insurance companies, and design manuals regulating supervision processes. Introduction and implementation of the system for comprehensive assessment of insurance companies' performance "CARAMELS" will make it possible to assess financial stability of companies by core indicators, including capital, assets, reserves, actuary calculations, management, yield, liquidity and market vulnerability.

With the view to coordinating supervision processes, the CBA is planning to develop in 2009 manuals "Off-Site Inspection of the Investment Companies", "Internal Inspection of the Investment Companies" and "Off-Site Inspection of the Insurance Companies". These manuals will describe in detail processes of the on-site and off-site inspections, and areas of inspection. The CBA will set forth new basic requirements for the internal audit and development of the risk management systems of insurance companies, as well as implement works on creation of conditions for the introduction of the Solvency 2 system in the insurance sector.

Meetings within the framework of the CPI Securities Market Regulating Board will continue. In 2009, meetings of the Board will be held in Armenia and chaired by the CBA Chairman. In 2009, the CBA will cooperate with supervisors from the Russian Federation for preparation of a new partnership agreement in the areas of securities market regulation and supervision. Works on joining the Multilateral Memorandum of Understanding (MOU) concerning consultation and cooperation and the exchange of information of the International Organization of Securities Commissions will continue. In case of joining the MOU, it will be possible to obtain data on securities market through foreign supervision agencies and benefit from mutual cooperation.