

Development Vision of the Central Bank of the Republic of Armenia

The Central Bank board, based on:

- Issues attached to the Central Bank by the Law on CBA,
- CBA philosophy approved by CBA Board,
- International best practices of stable economy development and perspective of European Integration,
- Motivation to play an important role in the financial services sector in the region,
- Tendencies of central banks’ development as the most important economic institutions and international best practices in that field.

has set the following objectives of CBA capacities and resources direction and development:

Monetary policy sector

- Low inflation contributing to a stable economic growth in a long-term period,
- Implementation of a monetary policy formulating open, transparent, stable expectations which are perceptible by the public
- Reliable and timely statistics release, in accordance with the best international criteria of that sector

Financial stability sector

- Development of healthy, stable and best managed financial institutions and markets actively servicing the economy, based on a unified philosophy.
- Deepening of financial intermediation through growth of financial market participants’ number and diversity, tools volume, number and diversity.
- Provision of quick and reliable servicing of larger operation volumes and variety of payment system-managed entities, using periodically updated tools and services
- Reliable and efficient organizing of cash circulation in the Republic of Armenia
- Ensuring general stability and standards of financial systems, including payment systems through continuous monitoring, complex preventive actions and modern methods of control.

Central Bank Institutional Development Sector

- Have a dynamically developing structure quickly responding to the economic environment changes and effectively influencing the economic processes.
- Be a reliable partner of RoA Government and other (international and private)

organizations

- Being the most important economic institution, act as a self-analyzing, continuously improving, human resources developing and learning organization.
- Effectively provide the full range of services specific for the central banks.

Under this vision, summarizing the progress of sectors addressed in the previous 2002-2005 strategy, as well as the situation with the sectors that still require some action, CBA plans the following activity directions for 2006-2008:

Strategic Directions of CBA 2006-2008 Activities

Monetary policy

In the middle of 1990-ies the Central Bank of the Republic of Armenia has adopted a monetary policy volume regulation or monetary aggregate targeting mode, which enabled it to manage the inflation rather efficiently during the recent years.

However, as the recent years’ experience proves, prioritizing the prices stability, CBA often deviated from the programmed indicators, preferring to ensure the planned inflation and financial market stability. The problem became more of current importance especially within the last two years, when an essential external inflow caused the inflation-exchange rate dilemma specific for small open economies. The CBA preference given to the programmed inflation level resulted in essential fluctuations of the exchange rate. CBA has had numerous meetings with the banks and the public explained in detail the reason for the rate fluctuations and program deviation. However, such deviations cause difficulties in stable expectations formation in enterprises and further inflation effective management. As the experience of several countries proves, the transition from a money volume targeting mode to an official inflation targeting mode can effectively solve this problem.

During the previous years the works aimed at inflation targeting, as well as the recent economic developments inspire CBA a confidence that it is ready for a transfer to inflation targeting, striving to implement a complete formal system of inflation targeting in a mid-term period.

1. Transition to inflation targeting mode.

1.1 Implementation of institutional bases for inflation targeting

1.2 Structuring of inflation forecasting short-term model and economy macromodel(s), their coordination and publishing

1.3 CBA activation in the financial market

1.3.1 CB tools development, including an optimum combination of treasury securities issued by the MFE and CBA securities.

1.3.2 Application of the interest rate as a directive policy tool at the monetary market

1.4 Deeper and more comprehensive communication with the public, through inflation forecasting and other publications.

2. Clarifications with the Government on cooperation in the macroeconomic regulation sector

Financial stability

The banking system of the Republic of Armenia is one of the most developed economy sectors and according to different assessments, is considered rather progressive in the region. Unlike other segments of financial services, the recent years’ dynamic economic growth was coupled with the banking system growth, consolidation and quality improvement, establishment of the most important infrastructures (e.g. deposit insurance, loan registers) as well as with essential improvement of CBA system control capacities. Also in the banking sector Armenia faces a number of important problems specific for the transition period countries. The banking system is small, fragile, has problems related to institutional establishment, economy risks rational distribution with other sectors of the financial market (insurance, investments), lack of “long” money, low level financial intermediation. Furthermore, contradictions in approaches recommended by various international organizations are often noticed in different sectors of the market.

A comprehensive and dynamic development of the financial system is possible only if a unified philosophy and unified approaches to the system regulation are developed. In this sense the Central Bank focuses on establishment of a unified supervisory body in its system. This approach presumes unification of banks, insurance and pension institutions, security market supervisory and regulatory functions in one authority, based on the CBA’s already established institutional expertise and independence. This approach is in line with the international experience of financial market unified development and unified monitoring of risks.

As per further development of the financial system, the Central Bank prioritizes market infrastructures, various tools and participants’ proportional development. As the recent years’ experience of the world economy and the Republic Armenia proved, efficient functioning of the financial market cannot be ensured without establishment of a trustful atmosphere between enterprises. In this case taking detailed supervisory regulation as a basis is an anachronism; it should be coupled with more active, risk-based supervision.

In any case, risks management is not only an administrative supervision issue, it should be implemented in any financial institution, by any enterprise. Thus, implementation of best practices of corporate management in the financial institution is of great importance, as well as transfer of the financial system corporate management positive experience to the real sector. Implementation of a corporate management in the transition countries like Armenia is more important, since the market order and entities’ activities monitoring by the market still need essential regulation.

Interrelated development specific for the financial markets today makes imperative a comprehensive and analytical approach to the sector. The financial stability concept in the economy is also of current importance for RoA and the Central Bank will take action based on the comprehensive and coordinated analysis to implement this function in accordance with the international best practices.

The main directions appearing from the vision are listed below:

3. Financial market development

3.1 Financial market infrastructures development

- 3.1.1 Support to establishment and activities of a foundation/company ensuring hypothec loans marketability
 - 3.1.2 Improvement of loans register services, supporting private loan offices establishment and activities
 - 3.1.3 Establishment of infrastructures contributing to foreign exchange and monetary markets activities, including wide application of stock exchange mechanisms.
 - 3.1.4 Support to provision of a sovereign international rating to RoA by international agencies and promotion of enterprises’ ratings use by RoA financial institutions.
 - 3.1.5 Support to private rating agencies establishment to transfer them the Central Bank’s temporary function of non-banks rating.
 - 3.1.6 Redefinition of capital market development policy.
- 3.2 Financial market new participants involvement and development legislation
- 3.2.1 Development of non-bank financial institutions and loan agencies
 - 3.2.1.1 Pension funds foundation
 - 3.2.1.2 Insurance sector
 - 3.2.1.2.1 Foreign capital participation limit elimination
 - 3.2.1.2.2 Promotion of modern criteria-based service providing entities’ attraction to RoA market
 - 3.2.1.2.3 Support to actuary institutions establishment
 - 3.2.1.2.4 Support to cases registration process in compliance with international standards
 - 3.2.1.3 Investment organizations’ legislative field establishment
 - 3.2.2 Promotion and regulation of cooperation between banks and other financial market structures.
- 3.3 New financial tools implementation support
- 3.3.1 In addition to implementation of domestic and foreign insurance companies’ internationally accepted services provision and control approaches, legally define and regulate life insurance, as well as third party losses mandatory insurance
 - 3.3.2 Ensure institutional environment for term supplementary tools development.
 - 3.3.3 Establish legislative and contract prerequisites for syndicated loans.
 - 3.3.4 Establish institutional environment for long-term financial investment tools development.

4 Transition to financial services unified supervision

- 4.1 Creation and establishment of a unified supervision system under CB structure

- 4.2 Harmonization of various financial institutions’ (banks, capital market, insurance, etc) regulatory fields
- 4.3 Implementation of supervision of market discipline observation and customers rights’ protection
- 4.4 Starting actions of transition to the third Bazel agreement, which is proper for the Armenian economy in the banking supervision sector.
 - 4.4.1 Risk assessment models development
- 4.5 Under the transition to second Bazel Treaty coupling of strict adequacy of supervision and risk-based supervision.
- 4.6 Controllers legal protection legislation establishment

5 *Transition to consolidated¹ control*

- 5.1 Ensuring beneficiary proprietors disclosure in all supervisory functions
- 5.2 Establishment of legislative and organizational bases for subsidiary companies risks.
- 5.3 Establishment of legislative and organizational bases for founder companies risks
- 5.4 Establishment of legislative and organizational bases for founder and subsidiary companies interrelated companies risks

6 *Improvement of corporate management in financial system*

- 6.1 Implementation of clear mechanisms of financial institutions executive body and proprietors’ responsibilities and management , as well as financial system corporate management positive experience transfer to the real sector.
 - 6.1.1 Description of board committees and mandatory functions and responsibilities
 - 6.1.2 Clear definition of the evaluation mechanisms and responsibility norms of the board and the executive body
 - 6.1.3 Ensuring systems guaranteeing the reliability of risks management and reports, including internal audit functionality.
 - 6.1.4 Defining fiduciary and subsidiary responsibility in line with management best practices.
 - 6.1.5 Clear definition of powers and responsibilities of the executive body and the board.

7 *Financial activities operational expenses reduction*

- 7.1 Support to mortgaging standardization and extrajudicial solutions practice
- 7.2 Adaptation of financial operations in the Civil Code to international standards
 - 7.2.1 Clarification of deposits and loans definition and calculation in accordance with international market criteria.

8 *Establishment of a functional system of fighting money laundering and terrorism financing (ML and TF) and implementation of mechanisms to confront ML and TF.*

¹Under the consolidated control an entity is viewed together with its subsidiaries, founders, and other organizations impacting its decisions.

- 8.1 ML and TF prevention
 - 8.1.1. Capacity building for establishment and updating a database of information provided by reporting organizations, as stipulated by RoA Law “ On struggle against criminally received revenues legalization and terrorism funding”, as well as for equivalent management.
 - 8.1.2. Capacity building for a high quality analysis of information received from reporting organizations and other sources.
 - 8.1.3. Informational collaboration with interstate and other motivated organizations, as well as information exchange and cooperation with overseas and international organizations.
 - 8.1.4. Trainings for Financial Monitoring Center staff on passing the acquired knowledge to reporting organizations, interested enterprises and the public.
- 8.2. ML and TF cases disclosure and actions aimed at their criminal prosecution.
- 8.3. Establishment of an intolerance atmosphere towards ML and TF through public awareness of their negative impact, as well as implementation of activities called to consecutively deepen the public knowledge necessary for fighting ML and TF.
- 8.4. Ensuring RoA participation in international efforts of fighting ML and TF and presentation of RoA standpoint to the respective international structures.

9 Implementation of financial stability monitoring and prevention mechanisms

- 9.1 Continuous monitoring and analysis of financial stability indicators,
- 9.2 Financial stability reports preparation and release,
- 9.3 Emergency action plan development

Statistics

As the primary statistic data provider of the financial sector the CBA has always adhered to information collection and processing in compliance with international best practices and has actively participated in ensuring Armenia’s membership in the Special Data Dissemination Standards (SDDS).

Under the conditions of a continuous financial inflow and official transition to the inflation targeting mode the Central Bank prioritizes the precise and detailed analysis of the payment balance, as well as development and release of indices evaluating the entities’ expectations. In this sector the Central Bank views its problems in the following directions.

10 Expansion of the financial system statistical coverage

- 10.1 Ensuring statistics on new financial organizations – loan, credit, pension, insurance and other financial institutions, in compliance with international criteria.
- 10.2 Evaluation of various financial flows (including cash and shadow).
- 10.3 Implementation of financial stability indicators’ statistical system.

11 Creation of statistical information ensuring inflation targeting

- 11.1 Implementation of an expectation evaluation institute in enterprises and households.
- 11.2 Compound economic indices and indicators calculation.
- 11.3 Evaluation of other economic links defining indicators (e.g. leading indicators) necessary for the inflation targeting.

Payment system development

The Armenian payment system had an essential progress in the recent years. New legal acts were adopted, which regulate payment systems’ activities, development, control and regulate the activities of payment companies. Due to the development of CBA payment systems the majority of interbank payments is implemented electronically. ArCa processing center was established in Armenia and “Armenian Card” unified payment system was implemented, which supports payments by Armenian Cards, as well as by international VISA and MasterCard. For servicing the transfers of individuals banks are using different international money transfer systems. Due to these developments enterprises were able to reduce their operational expenses, expand the scope of their international operations, receive high quality banking services.

Under the current technology developments the priorities are implementation of new banking technologies, risks control and limitation, ensuring normal operation of the systems, which will contribute to broad masses’ involvement in the banking sector. In this sense the Central Bank views its problems in the following directions:

12 Non-cash payment development

12.1 Ensuring non-cash circulation of small-scale payments

12.2 Ensuring state-paid benefits, pensions and other social payments through the banking system, particularly cards.

12.3 Development and implementation of new payment tools for the entities.

13 Payment systems regulation and control

13.1 Ensure the stability (security) of payment systems operated in Armenia through risks disclosure and limitation

13.2 Emergency action plan development

14 New technologies development

14.1 Under the ARCA unified payment system ensure smart cards issuance in 2006-2007, as well as servicing of smart and chip cards issued by VISA and Mastercard international systems.

Institutional Development of the Central Bank of the Republic of Armenia

The Central Bank of Armenia pays a great attention at its dynamic development as the most important entity implementing governmental management functions. In this sense the Central Bank always strived to be among the progressive leader structures of the country from the standpoints of the progressive European practices implementation in the management sector, policies transparency and perceptibility, as well as regulated partnership establishment with market participants and other public structures. As times are changing rapidly, the Central Bank, adhering to already established traditions and striving to be a constantly reformed structure, views the following development priorities.

15 CBA management systems development

- 15.1 Implementation of central banks’ corporate management international best practices.
- 15.2 Detailed description of all CBA operational processes and their
 - 15.2.1 Automating evaluation
 - 15.2.2 Evaluation of services acquisition on market basis
- 15.3 Consolidation of staff management system base on jobs evaluation system
 - 15.3.1 CBA staff potential and needs assessment and training system improvement based on this assessment.
 - 15.3.2 Staff rotation system implementation
- 15.4 CBA all management systems automating and integration

16 RoA scientific academic potential involvement in CBA activities

- 16.1 Constant dialogue with progressive universities ensuring economic education and their long-term cooperation in CBA research activities.

17 Alongside with more information provision to the market participants and the press in the PR sector, provision of scientific and educational information on the CBA role and functions to the public, particularly the youth.

- 17.1 Encouraging regular communication with the media under the inflation targeting strategy
- 17.2 CBA visitor center establishment
- 17.3 CBA library accessibility for the population.