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# QUARTERLY REPORT: FINANCIAL SECTOR DEEPENING PROJECT

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# QUARTERLY REPORT

FISCAL YEAR 2007: SECOND QUARTER  
(JANUARY – MARCH 2007)

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Financial Sector Deepening Project

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## ABBREVIATIONS

AAAA	Accountants and Auditors Association of Armenia
AML/ATF	Anti-Money Laundering/Anti-Terrorist Financing
ARMEX	Armenian Stock Exchange
CBA	Central Bank of the Republic of Armenia
CCN	Cooperating Country Nationals
CG	Corporate Governance
CO	Contracting Officer
COP	Chief of Party
CTO	Cognizant Technical Officer
DCA	Development Credit Association
EMG	Emerging Markets Group, Ltd.
FSDP	Financial Sector Deepening Project
GoA	Government of Armenia
IASB	International Accounting Standards Board
IASC	International Auditing Standards Committee
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
ISA	International Standards on Auditing
M&E	Monitoring and Evaluation
MoF	Ministry of Finance and Economy
MoFA	Ministry of Foreign Affairs
MoJ	Ministry of Justice
MOU	Memorandum of Understanding
NBFI	Non-bank Financial Institution
PMP	Performance Monitoring Plan
SEC	Securities and Exchange Commission
STTA	Short-term Technical Assistance
TA	Technical Assistance
USAID	U.S. Agency for International Development
WP	Annual Work Plan



## INTRODUCTION

### Background

In September 2006, the United States Agency for International Development (USAID) initiated a new 3 to 5 year, \$16 million project aimed at improving the functioning of Armenia's financial sector. The Financial Sector Deepening Project (FSDP or the Project) builds on previous USAID efforts in the banking, securities and financial reporting areas and is implemented by Emerging Markets Group Ltd. (EMG), a firm with extensive financial sector development experience operating in more than 60 countries around the world.

Broadly, the strategic goals of the FSDP are to catalyze and facilitate:

- Growth in financial intermediation
- Strengthened regulation and supervision
- Development of the financial sector infrastructure

This USAID engagement focuses on improvement of the efficiency and viability of financial intermediaries, financial sector development and is aimed at introducing a wider array of products in banking, mortgage insurance, pension and other areas. It also seeks to improve the soundness, safety, stability and integrity of the financial sector in Armenia by enabling the Central Bank of Armenia (CBA) to implement risk-based supervision on a consolidated basis. In addition to deepening the financial sector, the Project should help improve transparency, information sharing and governance in the sector reducing opportunities for corruption and misuse of information. At its core, the ultimate objective of the Project is to improve the quality and variety of financial services available to private enterprises, thereby promoting economic growth and development.

The Project is comprehensive in its scope, both with regard to its focus areas and the subjects it covers. FSDP is designed to engage the three major components of the financial system – private sector participants; the financial system's regulator; and the system's infrastructure – and thus is organized according to Teams focusing on each of these components. As mentioned above the Project is also a consolidated follow-on to the work of several previous USAID projects. FSDP's scope includes the banking, mortgage market, insurance, securities and pension sectors; it also touches upon the accounting and auditing industries as they relate to the financial sector. The overall goal is to continue building "vertically" within each sector but also emphasize and focus on creating the "horizontal" linkages that make a series of sectors actually perform as a modern financial system.

This report presents the second quarterly progress report for the period January to March 2007 for the implementation of the Financial Sector Deepening Project. It is provided in accordance with the Section F.5, Reports, Deliverables, and Outputs and Section F.6, Progress Reporting Requirements of Contract No. 111-C-00-06-00061-00 ("the Contract").

### Progress Highlights for the Quarter

FSDP has made substantial progress in commencing work under all components and finalizing staffing in this second quarter.

The staffing structure was substantially advanced with the mobilization of Resident Insurance Advisor Richard Webb (January 26<sup>th</sup>); Resident Banking Advisor John Fitzgerald (March 15<sup>th</sup>); FSN Banking Specialist Vahan Babajanyan (January 10<sup>th</sup> through our subcontracting partner, VGM); CCN Insurance Regulation Specialist Ara Karyan (February 7<sup>th</sup>). The component teams developed their internal work plans and division of labor and started detailed work with counterparts on the various project initiatives. The project started to get wide reception from the market and it gained recognition for a number of early initiatives, which has formed a solid foundation for implementation of the Work Plan.



Some of the key highlights of technical work on the project are as follows:

### **Component I: Intermediation**

- FSDP completed the creation of the banking industry database that will be used to analyze conditions in the industry, better program assistance, and support investment promotion activities. The outputs from this data, which were used to create a landmark presentation on the banking industry, were well received in the market and among stakeholders; and we believe helped publicize the project. The project also made important progress in preparing investment promotion materials on individual banks and discussing technical assistance packages, which form the basis for direct support to the industry.
- On the development of alternative financing schemes, the FSDP has been given a unique opportunity to assist Ararat Bank in preparing for the first public issuance of a corporate coupon bond in Armenia. This event has generated substantial publicity and it will enable the project to fashion its assistance around a transaction that could help catalyze a new class of investment in Armenia.
- Other important planning and scoping work was conducted by FSDP with Government of Armenia (GoA) counterparts, and other projects and donors in the area of mortgage market development, pension fund reform and insurance industry development.

### **Component II: Supervision**

- FSDP carried out a number of activities to support CBA's reorganization, a proposed sale of the Armenian Stock Exchange (ARMEX), overall regulatory strengthening; including the review of numerous new laws and regulations, which are outlined under Component III. FSDP provided material assistance to help the CBA define an organizational structure for unified regulation. This work was used at the CBA Board level to make decisions about structure and implementation planning. FSDP provided a range of ad hoc assistance to the CBA on operational issues. FSDP also had an opportunity to participate in the early stages of a landmark merger between ARMEX and OMX by providing comments and information used in negotiations by ARMEX and the CBA. This transaction represents a significant opportunity for the FSDP to enhance capital market intermediation and contribute at this early stage is a very positive development.

### **Component III: Infrastructure**

- FSDP provided substantive assistance to the CBA centered on reviewing, commenting, and proposing language for a several new laws and regulations that are being development. This work was time sensitive and provided substantive comments to the CBA that will help shape and prepare this legislation for review by the CBA Board and Parliament.
- In the area of information transparency, the FSDP made good progress in talking to the Accountants and Auditors Association of Armenia (AAAA) and the Ministry of Finance and Economy, Ministry of Justice and Ministry of Foreign Affairs concerning the updating and translation of accounting and auditing standards. The talks led to substantive findings helping us to address the barriers to translation, an action plan for project support, and other important matters<sup>1</sup>.

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<sup>1</sup> While these tasks were not part of the original scope of work for the FSDP, the quality of information is a significant barrier to access to finance in Armenia and belies the projects work under Component I to strengthen intermediation. Moreover, the willing interest of GoA counterparts and the AAAA at this time to undertake reform make this activity a worthy and timely pursuit. See the Work plan for further discussion of this area of work.



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## SUMMARY OF ACTIVITIES BY COMPONENT

The following is a detailed summary of FSDP activities for the quarter according to each of the main components and their subcomponents as outlined in the Work Plan.

### Component I: Intermediation

#### BANKING SECTOR COMPETITIVENESS AND INNOVATION

##### Database and Market Analysis

The banking sector database was completed and updated. This material was used to create a presentation on the banking sector to be provided to USAID, interested Embassy staff, the American Chamber of Commerce, and the banks themselves. It will also serve as the basis for the due diligence package to be prepared in connection with the Project's efforts to attract a reputable foreign bank into the Armenian market.

Using this database, the FSDP team delivered a presentation of its analysis on the Banking Sector Data, Trends & Correlations to the US Embassy in Armenia on March 22<sup>nd</sup> 2007. The presentation was made based on the selected results from FSDP Banking Sector Database that covered calendar years 2003 through 2006 and included all 21 Banks operating in Armenia. The database contained corporate data on the banks, financial statements and analyses, lending practices data, deposit activities and data management efficiency and profitability indicators. The presentation covered the make-up of the Armenian financial system and relative role in the economy, the current structure of the Armenian banking system, bank business and lending practices, correlations and bank scorings on profitability and productivity. The overall response that received from the USAID top management and US Embassy was that it conveyed great analysis and team work, very well thought conclusions and recommendations put into a logical frame and well linked to the Project's goals and objectives. An interest was expressed in receiving more frequent and regular updates on the project developments. The FSDP team is working towards doing more marketing of the project for the US Mission in Armenia and the overall audience. Further updates and more analysis on the other segments of the financial sector are being prepared and will be presented in the near future.

##### Investment Promotion

The individual banking reports were substantially completed. These will be included in the due diligence package mentioned immediately above. They will also be included on the Project's website. This is designed to educate consumers as well as develop investment promotion material.

Collection of data for a comparison report on banking services and rates was completed and the database comparing the rates for banking services, loans and deposits across the 21 Armenian banks was finalized. We intend to publish these results on the FSDP's website as part of the consumer education focus.

##### Assistance to Banks

The Project met with the Chairman and other officials of Armswissbank in order to specify the assistance that FSDP can provide the Bank.

FSDP conducted a series of individual, private information sessions for the General Directors of several Armenian Banks to educate them on the status of their bank within the sector. This covered relative market share, comparative make-up of revenues and expenses, comparative compensation regimes, relative profitability and productivity of their bank and suggestions for new products. The goal was to provide them with tailored strategic data regarding their bank, stimulate their focus on innovation and emphasize the need for more innovation in products and services. These briefings were provided one-on-one to the following individuals:



Ashot Osipyan	Ararat Bank
George Machanyan	Armswiss bank
Mher Grigoryan	Ineco Bank
Vardan Atayan	Unibank
Armen Khandkaryan	Areximbank
Artak Hanesyan	Converse Bank

The Project met with different Banks, Universal Credit Organizations and other institutions to introduce them to the FSDP and discuss a framework for future cooperation. A draft MOU for selected partner banks is in progress. We conducted introductory visits and/or follow ups to establish or reinforce relationships between key participants in the Armenian financial sector and the Project with the following individuals:

Person	Position	Organization
Vardan Movsesyan and	Board Member	CBA
Karine Minasyan	Board Member	CBA
Arthur Javadyan	Vice Chairman	CBA
Vardan Petrosyan	Executive Director	Mortgage Markets Assoc.
Vahan Stepanyan	General Director	Central Depository
David Avetessian	Deputy Minister	MOFE
Aharon Chilingaryan	General Director	Aharon Paradigma CJSC
Ashot Osipyan	General Director	Ararat Bank
Sergey Melik-Yolchyan	General Director	Avantguard Insurance Broker
Artavazd Yakhshibekyan	General Director	First Insurance Brokerage Co
George Machanyan	General Director	Armswiss Bank
Hovhannes Petrosyan	General Director	Armenian Accounting and Auditing Association
David Antanessian	General Director	First Mortgage Co
Levon Mamikonyan	General Director	Cascade Insurance
Nerses Karamanukyan	Country Representative	IFC
Mher Grigoryan	General Director	Ineco Bank
Vardan Atayan	General Director	Unibank
Armen Khandkaryan	General Director	Areximbank
Artak Hanesyan	General Director	Converse Bank
Armen Khachyan	General Director	Washington Capital
Armen Khandkaryan	Chairman	Areximbank
Yervand Barsegyan	General Director	FINCA
Vadim Usvitsky and Arsen Kuchukyan	General Director and Deputy General Director	State Enterprise Fund
Bagrat Asatryan	CEO	Garni Invest
Hergnyan Manukyan	Country Representative	World Economic Forum

We also delivered a presentation on the Banking Sector database for USAID on January 29, 2007, to the Banker's Association on February 7, 2007 and to the CBA on February 22, 2007.

#### **MORTGAGE MARKET DEVELOPMENT**

FSDP staff met with Vardan Petrosyan, Director of the Mortgage Markets Participants Association to discuss future assistance by the FSDP. We also attended the Association's annual meeting.



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## **IMPROVED INSURANCE INDUSTRY**

The Chief of Party (COP) met with CBA Board Member Vardan Movsesyan to begin the process of attracting a foreign insurance firm into the Armenian market.

## **MANDATORY AND VOLUNTARY PENSION SCHEMES**

The Project met with Pension Reform Group members (CBA) to coordinate our efforts with regard to pension reform (designing the new detailed Operational Plan and sharing of information on regular basis); we submitted some general recommendations related to thematic groups inside the interdepartmental Working Group. These were accepted and implemented.

As a follow up to our involvement in the pension reform area, FSDP staff attended a 2- day meeting with CBA officials, other Ministerial representatives, members of the pension working group and other international experts regarding alternative policy choices a program design.

## **DEVELOPMENT OF ALTERNATIVE FINANCING SCHEMES**

### **Corporate Bonds**

FSDP staff met with Ararat Bank concerning its interest in issuing corporate bonds and improving its risk management. The Project agreed to assist the bank in its planned offer of corporate bonds and to review the bank's credit scoring techniques. With regard to the former point it appears that this offering will constitute the first ever public sale of coupon bonds by an issuer.

The COP spoke at a press conference sponsored by the CBA and Shen Concern CJSC (recent issuer of corporate bonds) to highlight the FSDP's willingness to work with potential issuers of securities. The Project also prepared and distributed a small brochure in this regard. This event (and the Project's comments) was covered on television and in newspapers.

### **Other Support**

The COP provided comments to the Mission (J. Caracciolo) on documents related to the Inecobank DCA guarantee and 2 sets of comments on documents related to the First Mortgage Co DCA guarantee.

## **COMPONENT II: SUPERVISION**

### **UNIFIED SUPERVISION**

#### **CBA Reorganization and Related Issues**

The Project met with CBA Board members and Department Heads to scope and plan for assistance to support the CBA staff reorganization. In this regard, we collected documents and information from the CBA with respect to its organizational structure and supervision scheme and prepared documents as follows: (1) overview of CBA current organizational structure; (2) list of entities subject to CBA supervision; (3) staff allocations involved in the supervision procedures. The project also prepared a Summary of Financial Supervision Approaches for 36 countries.

In February, the FSDP provided STTA to the CBA in making decisions on the revision of its organizational model to become an effective unified financial regulator. We were asked to review the preliminary structure developed by the CBA and provide input on some of the detailed organizational design issues (at the department, unit, and sub-unit level); formulate alternatives and identify enhancements to the current organizational structure that will enable the CBA to strengthen its operations for sector-wide regulation of banks and non-bank financial institutions (NBFIs); identify where new regulatory activities will be needed for integrated regulation; and outline various implementation measures that will be needed to facilitate integration on a functional and process-oriented basis. The purpose of this work was to provide information that will help facilitate CBA Board discussion of the various alternatives for reorganization, help the CBA



develop systems and procedures for market conduct supervision, and provide guidance to the staff in the Policy Department in addressing selected issues that arose during the CBA's research on integration.

The field visit, which was conducted by Anthony Sinclair of Emerging Markets Group, commenced on February 10<sup>th</sup> and ended on February 21<sup>st</sup>. A Trip Report summarizing his work and outputs is attached in **Appendix A**. Based on the results of the diagnostic review and discussion with the CBA, a set of detailed organizational models were prepared that outlined organizational enhancements and departmental structures. These models were presented in an interim meeting with Vache Gabrielyan (Member of the CBA Board) and representatives from the Policy Department. The various pros and cons of each model were discussed.

The feedback from the CBA on the diagnostic review and organizational models work was positive. The Diagnostic Report was used by the CBA Board in its deliberations and it chose to implement one of the four models submitted by the FSDP for consideration.

While the nature and timing of future FSDP support will depend on the outcome of CBA Board discussions, it is likely that the next stage of work will center on detailed implementation and the development of tools and methodologies.

### **RISK-BASED AND CONSOLIDATED SUPERVISION**

The initial outline of a risk assessment framework and its application was provided to the CBA as part of the deliverable provided with the STTA conducted in February. Further support for development of a risk rating system and its implementation is planned once the CBA has made further progress on its reorganization.

### **PENSION FUND SUPERVISION**

FSDP had various discussions with the USAID SPSS project about each project's respective roles in connection with pension reform in general, and supervision in particular. For most of the quarter the SPSS project was engaged in mobilization, so no substantive work on this area is still in development. FSDP will undertake activities that support development of the enabling regulatory environment for Pillar II and Pillar III; as such much of this work will also fall under the overall regulatory strengthening work that will be provided to the CBA on securities market regulation and fund manager supervision.

The FSDP also had preliminary discussions with the CBA on where pension fund regulation should be located. However, this is still under evaluation by the CBA, MoF and Ministry of Labor and Social Affairs.

### **OTHER NEAR-TERM ACTIVITIES IN ENHANCING FINANCIAL SUPERVISION**

#### **Support to CBA on OMX-ARMEX Merger**

We reviewed the document "Capital Market Review and Design Study" designed by OMX and submitted our detailed comments and recommendations to CBA. Many of these points were used by the CBA in its ongoing negotiations concerning the possible acquisition of the ArmEx and CDA by OMX. This potential merger represents a significant development for the ARMEX and the Armenia capital market. FSDP intends to maintain support by providing information and analysis where needed to support the CBA and/or ARMEX.

#### **Insurance Regulation**

At the request of senior management of Cascade Insurance, the COP met with the Levon Mamikonyan (the Managing Director of Cascade Insurance) regarding supervisory and regulatory problems they face. The FSDP subsequently had informal discussions with certain senior CBA staff members to understand the CBA's views and goals, but the Project did not take on an advocacy role.

#### **Strengthening of Enforcement Practices**

For the CBA we began a review of the general principles and concepts applicable to sanction determinations. FSDP prepared a draft report on the present situation on sanction determinations and enforcement practices



in the banking sector, based on analyses of laws, regulations and internal acts of the CBA. We moved ahead and drafted initial recommendations on reform in sanction determinations and enforcement areas. We also, identified and started to review the experience of other countries (the US, the UK, Estonia, etc.) in sanction determinations and the enforcement areas.

### **Support to the Depository**

We met with the Head of the Central Securities Depository to discuss their technical assistance needs.

### **FRAMEWORK FOR FIGHTING MONEY LAUNDERING, TERRORIST FINANCING & CORRUPTION**

Within the first month of project start-up, the project met with Nerses Yeritsyan, Advisor to the CBA Chairman, to explore what assistance was being provided by the donor community in the area of Anti-Money Laundering and Anti Terrorist Financing (AML/ATF). He indicated that there were several donors involved, including: (1) Council of Europe; (2) UNDP; (3) IMF; and (4) US Treasury working on these issues. According to Mr. Yeritsyan these entities are addressing most of the line items contained in the Contract Work Plan Item 2.4 (line items 42-46), except for training for the banks on Financial Intelligence Unit (FIU) activities, reporting requirements and business incentives for strong reporting.

In light of this information, the Project has agreed to provide the training for the banks. At the same time, we indicated to Mr. Yeritsyan (and he agreed) that generating bank support and interest in this topic would be easier after the Project had established relationships with the firms in connection with new product development and other profit—enhancing efforts.

For this reason, although we intended to sponsor the FIU training, we did not conduct any activities within AML during Q2. It should be noted also that currently there are other developments occurring in this area, such as Armenia becoming a member of the Egmont Group and procedures being revised for reporting by bank and information sharing between countries. When these are finalized we will commence the training based on the schedule requested by the CBA. Most likely this will occur in Q4.

## **COMPONENT III: INFRASTRUCTURE**

### **LEGAL REFORMS**

#### **Banking**

The Project completed a review of amendments to various laws for CBA as follows:

- Law on Credit Organizations (registration of branches).
- Law on Banking Secrecy (information disclosure requirements).

#### **Securities**

We prepared general comments to a 1<sup>st</sup> draft of the Law on Securities Market securities law and submitted them informally to the CBA Legal Department. Substantially all of the Project's comments were accepted by the Legal Department. Thereafter we reviewed a 2<sup>nd</sup> draft received from CBA and met with the members of the working group to discuss and provide recommendations. Again substantially all of our comments were accepted and incorporated.

The Project completed a review of amendments to various laws for CBA as follows:

- Law on Securities Market Regulation (cross border trading).
- Company Law (corporate bond issuance).
- Civil Code (corporate bond issuance).

For each draft set of amendments we submitted our comments informally, in keeping with our approach to serve as “internal advisors” who obtain drafts at an early stage (while in drafting by CBA Departments),



thereby facilitating greater access and impact. In almost all instances the CBA staff accepted our comments and recommendations. Our collected set of comments will be submitted as a deliverable report.<sup>2</sup>

The Project received from CBA and began a review of draft amendments to the regulation on “Registration Statement of Securities and Reports of Reporting Issuers”.

For the CBA, we began review of the draft Law on Securitization and Asset Backed Securities.

### **Insurance**

For the CBA, we submitted detailed comments (approximately 100 pages) to the Insurance Law and amendments to the Civil Code which at that time had passed first and second readings in the Parliament. This followed a meeting among V. Gabrielyan, V. Movsesyan, D. Sargsyan and V. Avedikian in which the FSDP was informed that Parliamentary consideration of the Insurance Law had unexpectedly been placed on fast track. Although these could not be incorporated into the draft subsequently enacted, the CBA has indicated they will be included in a package of amendments scheduled for September 2007.

### **Mortgages**

We submitted to USAID a confidential memorandum analyzing the recent amendments to the Law on Currency Control and its impact on mortgage lending. Afterwards we prepared a public version of the memorandum for release to mortgage market participants.

### **INFORMATION SHARING**

The Project submitted a detailed letter to the CBA containing suggestions for improving the quality of information publicly available regarding the commercial banks, especially with regard to disclosures in the footnotes to the banks’ financial statements. The letter also noted suggested improvements to the CBA website.

### **CORPORATE GOVERNANCE**

The Project met with the Head of the IFC Armenian office and discussed the framework of possible cooperation, particularly in the framework of CG assessment in financial (banking) sector of Armenia. After the meeting we received the Results of IFC’s Survey on CG at Armenian banks from IFC local office, conducted in 2006 May.

### **PROFESSIONAL EDUCATION, TRAINING, AND OTHER CAPACITY BUILDING INTERVENTIONS**

The project did not conduct professional training sessions in a seminar or conference setting. However, we did conduct a series of individual, private information sessions for the General Directors of several Armenian Banks to educate them on the status of their bank within the sector as noted under Component I.

### **OTHER ACTIVITIES**

#### **Accounting and Auditing**

As a follow up to meetings with the AAAA on accounting and auditing issues in Q1, the Project met with David Avetissian, Deputy Minister of Finance and Economy, to discuss the updating of the translations of accounting principles and auditing standards. In this regard we also met with 2 separate leading practitioners to solicit their views on updating the accounting and auditing principles.

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<sup>2</sup> This occurred prior to an understanding reached between the Project and the CTO that all deliverables will be submitted at least contemporaneously with (and preferably prior to) delivery to counterparts, for review and no objection by the Mission.



Afterwards FSFP drafted a report to the CBA and MoF with corresponding recommendations on key legal obstacles that hamper the official translation and adoption of IFRS/ISA in Armenia as international accounting standards. This package also contained (1) a detailed action plan for coordination with the MoF and other responsible parties the procedure, schedule and responsibilities of involved parties for IFRS's official translation and national adoption by Armenian Government after their approval by the IASC/IASB; (2) a detailed Policy Statement – procedures for starting the process of official translation and national adoption of IFRSs in accordance with the IASC/IASB requirements and submitted to the MoF of RA for coordination; and (3) the organization structure of the translating team and submitted to the MoF for coordination. We also had several contacts with Ministry of Justice (MoJ) and Ministry of Foreign Affairs (MoFA) on clarification of Legal problems of official translation and national adoption of IFRSs and discussed with the AAAA the status of current preparatory and organizational activities and necessity to coordinate our relevant steps.

## DELIVERABLES

The following deliverables were presented during this second quarter:

1. **Presentation to the Embassy.** The FSDP team delivered a presentation entitled Banking Sector Data, Trends & Correlations to the US Embassy in Armenia on March 22<sup>nd</sup> 2007. This presentation is included under Attachment B.
2. **STTA on CBA Staff Reorganization.** The Project provided STTA to the CBA to support its reorganization and creation of a framework for supervision on March 1, 2007.
3. **Comments to Law Amendments.** The Project completed a review of amendments to various laws for the CBA as follows:
  - a. Law on Securities Market Regulation (cross border trading)
  - b. Company Law (corporate bond issuance)
  - c. Civil Code (corporate bond issuance)
  - d. Law on Credit Organizations (registration of branches)
  - e. Law on Banking Secrecy (information disclosure requirements).
4. **Comments to OMX Study.** We reviewed the “Capital Market Review and Design Study” issued by OMX and submitted our detailed comments and recommendations to CBA on March 13, 2007.
5. **Comments on Currency Controls.** We submitted to USAID a confidential memorandum analyzing the recent amendments to the Law on Currency Control and its impact on mortgage lending on February 23, 2007.
6. **Comments to New Insurance Law.** For the CBA, we submitted detailed comments (approximately 100 pages) to the Insurance Law and amendments to the Civil Code by Feb 26, 2007.
7. **DCA Guarantees.** The COP provided comments to the Mission (J. Caracciolo) on documents related to the Inecobank DCA guarantee by February 14, 2007 and 2 sets of comments on documents related to the First Mortgage Company DCA guarantee on February 3, 2007.
8. **Comments to New Securities Law.** We prepared general comments to a first draft of the Law on Securities Market and submitted them informally to the CBA Legal Department on February 21<sup>st</sup>. Substantially all of the Project's comments were accepted by the Legal Department. Thereafter we reviewed a 2<sup>nd</sup> draft received from CBA and met with the members of the working group to discuss and provide additional recommendations. Feb 12, 15 and 19-21. Again, substantially all of our comments were accepted and incorporated.
9. **Suggestions to Improve Banking System Transparency.** The Project submitted a detailed letter to the CBA containing suggestions for improving the quality of information publicly available regarding the commercial banks, especially with regard to disclosures in the footnotes to the banks'



financial statements. The letter submitted on February 23, 2007 also noted suggested improvements to the CBA website.

10. **Consultations on Sanctions Framework.** For the CBA we began a review of general principles and concepts applicable to sanctions determinations. FSDP prepared a draft report on the present situation on sanction determinations and enforcement practices in the banking sector, based on analyses of laws, regulations and internal acts of the CBA. We also drafted an initial set of recommendations on the reform in sanction determinations and enforcement areas. Finally by April 12, 2007, we identified and started to review the experience of other countries (the US, the UK, Estonia, etc.) in sanction determination and enforcement areas.

## **COORDINATION AND COLABORATION WITH GOA, OTHER USAID PROGRAMS AND DONORS**

### **Coordination with USAID and US Government Sponsored Programs**

#### **SPONSORSHIP OF CBA STAFF AT US SEC SECURITIES MARKET DEVELOPMENT PROGRAM**

During Q2, the CBA received an invitation from US Securities and Exchange Commission (“SEC”) for CBA employees to participate in the 2007 International Institute of Securities Market Development. This is an annual two-week program that the SEC has offered for representatives of the world’s emerging securities markets and their regulators since 1991. The Institute provides an opportunity for participants to learn from those most knowledgeable in the US and from one another on how to promote safe and efficient securities markets and the different ways in which to achieve these goals and encourage economic opportunities and growth. It is held at the SEC’s headquarters in Washington DC, USA.

Subsequently the CBA, through USAID Armenia, requested that the Project support and finance the participation of three selected employees in this training. The following participants were selected for the training – Artak Yengoyan, Head of Securities Market Licensing and Registration Division, Securities Market Department, Karen Hakobyan, Senior Securities Expert of Insurance and Securities Market Regulation Division, Financial System Policy and Analysis Department and Varoujan Avedikyan, the Head of CBA Legal. Unfortunately as of the close of the reporting period, Mr. Avedikyan indicated he would not be able to attend the SEC training due to his busy schedule.

As the Academy for Educational Development is the primary and the only training contractor for the Mission’s participant training program and is the only one source reasonably available to assist us in this effort we subcontracted with them to provide facilitation services for obtaining the entire necessary package for this trip that would include J-1 visa, medical insurance etc. All other logistics and remaining details have been covered by Emerging Markets Group.

The training will take place in April and a report will be included in the next quarterly report.

#### **OTHER COORDINATION RELATED ACTIVITIES WORTHWHILE TO BE MENTIONED.**

- The FSDP team conferred with AED concerning their scope of work in the accounting and auditing areas.
- The Project met with the Board of Directors of AIPRG on future cooperation.
- FSDP met with the USAID SME project with regard to agricultural insurance.
- We consulted with the visiting mission of MCA regarding their agricultural sector program.
- The Project met with SPSS and visiting TSG representatives to discuss project coordination with regard to pension reform efforts.



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## Coordination with Other Donors and the GOA

At the request of USAID we met with a World Bank consultant working on the issue of customs bonds and instruments of performance guarantee.

We agreed with AEPLAC to coordinate our efforts in translation of two drafts of laws (Insurance Law and Securities Market Law) and related amendments.

The Project agreed with the KfW Mortgage Project on division of efforts.

FSDP met with the visiting mission of UN IFAD regarding their plans for a venture fund for SME's.

We are in coordination with AEPLAC regarding the translation of two drafts laws (Insurance Law and Securities Market Law) and related amendments;

The Project met with the local office of AIPRG to discuss their involvement in surveys and research.

FSDP met with IPC representative (Ulrich Weber) concerning ProCredit's request for technical assistance and the impact upon efforts to attract a reputable foreign bank into Armenia.

Project staff met with the head of the IFC's Country office Nerses Karamanukyan regarding their anticipated activities in financial sector of Armenia including their efforts for improvement of corporate governance practices in financial market institutions.

## PROJECT MANAGEMENT, MONITORING AND EVALUATION

### Work Plan

An annual work plan for the first contract year of the Project has been documented and is in process of implementation. As of the close of this quarter, the Work Plan report was still under process of editing and revision. It is anticipated that the report will be finalized by the first part of the second quarter, pending further recommendations by the Mission.

### Monitoring and Evaluation Plan

The FSDP has an approved Performance Monitoring Plan ("PMP") as part of its contract with the USAID mission in Armenia that outlines a set of indicators, information sources and measurement criteria by which to assess the progress of the project in achieving reforms in these three areas. The PMP was developed at the initial stages of proposal and EMG was given an opportunity to revisit it in order to revise and fit it to the current situation in country and in the field.

Fine tuning was needed in two respects: first, there is a need to ensure that the PMP is aligned with the Work plan and that the indicators proposed during the bidding stage of the project are relevant and appropriate. Second, there is a need to ensure that the PMP, to the extent possible, will be aligned with and support the upward reporting responsibilities of the Mission and its evolving M&E obligations. Implementation assistance is needed in establishing baseline data for main indicators, identifying and validation data sources, and implementing an M&E framework that can be easily understood and applied by project staff.

During Q2, Mr. Leo Surla, the President of MetaMetrics Inc. and an expert specializing in the design, appraisal, assessment, planning, implementation, and evaluation projects for international development agencies provided STTA to assist the Project in finalizing the approved PMP, preparing the baseline data, and implementing the data collection and measurement tasks that will be required by the PMP.

His specific tasks included:

Assistance in refining the approved PMP to reflect the current situation on the ground and the approved work plan. This involved rewriting PMP to reflect the changes in the first year work plan, reviewing the proposed PMP indicators to ensure that those are formulated in a form of results, are measurable, yet ambitious and adequate to the level of TA provided, and making "fine-tuning" recommendations that will help strengthen the PMP and its application.



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Assistance to align the PMP with the anticipated upward reporting requirements of the Mission. This will involve reviewing the Mission's upward reporting requirements (standard indicators and customized indicators) and making recommendations on how the PMP can be used to better support the Missions reporting obligations.

Assistance with the implementation of the PMP by identifying the relevant data sources and baseline data, preparing the necessary instructions for data collection and evaluation, and providing guidance on the overall PMP implementation and its resource requirement.

Providing on-the-job training to Project staff that will be responsible for implementing the PMP, and the collection and reporting of data.

The following deliverables will be incorporated into the 3<sup>rd</sup> quarterly report:

- List of recommended enhancements/revisions to the PMP with supporting rationale.
- List of recommendations/instructions on how data should be collected and evaluated.
- Description of on-the-job training of designated FSDP Project staff on evaluation methodologies for subsequent implementation of the Plan.

## **Project Publicity**

### **WEBSITE**

The Project's web hosting has been established and the architecture for the site finished at: [www.fsdp.am](http://www.fsdp.am). We are currently working on the content and will go live when there is sufficient material; as we want to avoid going live with a "skeleton" site. We are also developing a library of relevant financial sector laws and regulations, in Armenian and English, which will be an online tool offered via our website. We have also begun creating our glossary of technical terms for the financial sector which will also be offered via the site.

### **PRESS COVERAGE**

In connection with the bond offering support provided to Ararat Bank, the FSDP COP spoke at a press conference sponsored by the CBA and Shen Concern CJSC (recent issuer of corporate bonds) to highlight the FSDP's willingness to work with potential issuers of securities. This event (and the Project's comments) was covered on television and in newspapers.

## **OUTSTANDING ISSUES AND CONCERNS**

No new material outstanding issues and concerns arose during this period.



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## **APPENDICES AND ATTACHMENTS**

**Appendix A: STTA Trip Reports**

**Attachment B: CBA Integration Review Report February 2007**

**Annex B.1: Comparison of Organizational Models**

**Annex B.2: Standards for Market Conduct**

**Attachment C: Banking Sector Data, Trends & Correlations Presentation to US Embassy in Armenia**