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QUARTERLY REPORT: APRIL-JUNE 2007

FINANCIAL SECTOR DEEPENING PROJECT

July 10, 2007

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QUARTERLY REPORT

APRIL - JUNE 2007

Submitted by:

Emerging Markets Group, Ltd. - Financial Sector Deepening Project

Submitted to:

United States Agency for International Development -- Armenia

Contract No.:

111-C-00-06-00061-00

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ABBREVIATIONS

AAAA	Accountants and Auditors Association of Armenia
ACRA	Armenia Credit Reporting Agency
AML/ATF	Anti-Money Laundering/Anti-Terrorist Financing
AMMPA	Armenian Mortgage Market Participants Association
ARMEX	Armenian Stock Exchange
BIS	Bank for International Settlements
CBA	Central Bank of the Republic of Armenia
CCN	Cooperating Country Nationals
CDA	Central Depository of Armenia
CG	Corporate Governance
CO	Contracting Officer
COP	Chief of Party
CTO	Cognizant Technical Officer
DCA	Development Credit Association
EMG	Emerging Markets Group, Ltd.
FIU	Financial Intelligence Unit
FSDP	Financial Sector Deepening Project
GoA	Government of Armenia
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFC	International Finance Corporation
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IOSCO	International Organization of Securities Commissioners
ISA	International Standards on Auditing
KfW	Kreditanstalt für Wiederaufbau
LOI	Letter of Intent
M&E	Monitoring and Evaluation
MoFE	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
RBS	Risk-Based Supervision
SEC	Securities and Exchange Commission
SME	Small and Medium-Sized Enterprises
STTA	Short-term Technical Assistance
SMSA	Securities Market Support Activity
TA	Technical Assistance
UBA	Union of Banks of Armenia
USAID	U.S. Agency for International Development
WP	Annual Work Plan



INTRODUCTION

This Report presents the implementation progress for the Financial Sector Deepening Project (FSDP or the Project) during the quarter April 2007 through June 2007. It is provided in accordance with 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”).

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 broadening and deepening the Armenian financial system by introducing a wider array of products in banking, mortgage, insurance, pension, securities and other areas, available to a greater segment of the Armenian population. 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 areas. 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.

Progress Highlights for the Quarter

The Project is now in full gear, with all teams focusing on technical implementation and work plan results. Local and international staffing is essentially complete. The Project is now working with EMG Home Office to refine the progress reporting regime, complete the performance monitoring framework, and elevate efforts to publicize early successes and build momentum from them.

We are very pleased with the early progress of the Project, in particular the counterpart relationship with the CBA and the various market opportunities that are arising on the private sector side (including those that are synergistic with USAID DCA and other US Government efforts). As we noted in the previous quarterly report, there are some excellent opportunities for the Project to contribute to the development of new products, inward investment, and expansion of intermediation. The Project was able to forge a valuable role



for itself with many of the counterpart institutions involved in these opportunities, and much of the work during the quarter was centered on technical delivery to these institutions.

Some of the key highlights of technical work during the quarter are as follows:

Component I: Intermediation

- While progress was made during the quarter under all components, FSDP made significant advancement under the Intermediation area; several new windows of opportunity for market impact arose. First, several foreign financial institutions began intensive due diligence with the aim towards buying Armenian banks. There are 4 banks targeted for purchase; the Project has been involved in 3 of these 4 transactions. Second, the Project substantially supported the first ever coupon bond offering in May. Third, after this success, several banks expressed interest in finding new ways to source long-term funds. In cooperation with several of our partner banks, the Project began designing new certificate of deposit products and an IPO of one bank's common shares. Fourth, the Project began designing new products for the banks aimed at attracting new customers. Ownership certificates for gold and floating rate loans are a few of the new instruments being developed on a pilot basis. Efforts on product design for factoring and leasing and municipal finance have also commenced.
- FSDP made its final presentations to the banking industry on the financial sector database. Work has begun on updating and expanding the database to include comparative financial information and market data for consumer use, bank specific data for investment promotion use, and development of modules for non-banks, such as UCO's. Work also commenced on doing the same for the insurance industry.
- FSDP also inaugurated its ongoing training program open to all banks. We began with an Introduction to Risk Management offered June 20-21 and attended by 52 persons.
- Several streams of work are now being followed on insurance market development. Work commenced on relationship-building with the insurance association and product development. Efforts are also underway to work with the CBA on the development of a statistics center, the development of an actuarial certification program with a reputable international organization, and regulatory strengthening.
- On the mortgage side, FSDP activity continued to focus on the legal and regulatory issues surrounding secondary market development. However, new inroads were also made on credit reporting reform and the development of title insurance that will eventually have a direct impact on the quality and growth of the mortgage lending.
- FSDP's work on pensions is a collaborative and supportive effort, with much of the work centering on Pillar II and Pillar III development. The Project made every effort to contribute where possible to these efforts during the quarter.

Component II: Supervision

- Two of the three baseline international regulatory assessments have been completed (Basel and IOSCO) and the third is scheduled for completion in the first part of the next quarter. These assessments will be used for both performance monitoring and the development of reform agendas which the project intends to help implement.
- Based on TA provided by the Project last quarter the CBA selected a model for reorganization. Implementation of this model has commenced. The CBA requested FSDP to provide a second phase of support for implementation by addressing a range of questions on detailed organization. The CBA wishes to complete the departmental reorganization before moving to reform of processes and methodologies. FSDP will remain active in talking to the CBA about the next steps.
- FSDP issued a report to the CBA on pension fund regulation and it provided comments to the pension reform white paper.



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- Work on insurance supervision commenced and the Project has started the early stages of work on the development of a CAMEL rating system, which is a foundational element of risk-based supervision.
- FSDP provided additional ad hoc support to the CBA related to the potential merger between OMX and ArmEX, investment related issues, and overseas training at the US SEC.

Component III: Infrastructure

- A substantial stream of work continued for flow in connection with the review of pending laws and regulations at the CBA. The Project has worked quickly to try to get comments on numerous laws and regulations to the CBA before the drafts are finalized.
- Work on credit reporting, and in particular support for mortgage-related reporting, geared up during the quarter as the Project had a number of important discussions with the CBA, ACRA, and the mortgage association, AMMPA.
- FSDP undertook an expanded level of activity to improve the quality and reliability of financial reporting in ways that will support access to credit and improve the environment for private sector development. The Project has committed to support the MoFE in the official translation of international accounting standards. The requirements of International Accounting Standards Committee (IASC) are strict and considerable time has been devoted to devising the organization, procedure and workplan acceptable to the IASC for this subproject. As of the close of the quarter, however, the Project is ready to recruit and retain the required personnel and commence the translation process..
- The Project identified the need for three important studies that will support the work on corporate governance, training, or product development: (1) study on corporate governance practices and systems within Armenian banks; (2) a market study on training needs and training infrastructure; and (3) a general public survey to better understand consumer usage, needs, and perceptions of financial services. The need for a fourth study, one to support remittance product development, is being considered. The Project has also started outreach to universities and private sector providers for collaboration on some of these studies and training development.



SUMMARY OF ACTIVITIES BY COMPONENT

The following is a detailed summary of FSDP activities for the quarter according to each of the main work plan components and their subcomponents.

COMPONENT I: INTERMEDIATION

BANKING SECTOR COMPETITIVENESS AND INNOVATION

Database and Market Analysis

On May 8th, FSDP made its last presentation on the banking sector database, this time to a group of banks that had not attended the previous sessions. FSDP also made a presentation to the AmCham which was well-attended (35 persons) and well-received (good interaction from the audience and long Q&A session afterwards). The AmCham sent a gracious thank you note that we forwarded to the Mission.

The Project continued to work on the development of the database; adding and updating information and expanding the scope of the data for broader use which is relevant to investment promotion and bank product development. There were three main accomplishments. First, the team updated the Banking Sector Report and Individual Banking Reports. Data on bank by bank revenues, expenses, lending practices, compensation practices profitability scores and productivity scores was added and used in presentations to external investors (as discussed below under “Assistance to Banks”). Second, we met with the CBA staff to discuss how the Project’s data and conclusions differed from theirs. As it turns out the differences are purely a consequence of differences in analytical focus and the use of different indicators. Thirdly, FSDP also updated the Comparison Report on Banking Services and Rates. This will be placed on the website as consumer information.

Data collection for the development of a database for non-bank institutions, in particular UCO’s, also started. Beyond basic data on these institutions, additional information will be needed on the financial position of these institutions that is not readily available through public sources. Unlike the situation with the banks, there is no requirement in the law that UCOs place their financial statements and other disclosures on the internet. Therefore, FSDP is relying on the CBA for documents and summary financial information on the UCO’s. This may take some time, and the CBA may choose not to provide the same information as provided on banks. Nevertheless, when ready, this database will be used to achieve the same goals as the banking database.

Investment Promotion and Transactional Assistance

A number of new investment promotion opportunities emerged this quarter, which the Project was able to capitalize on.

Investment Promotion in Connection with Armimpex and Areximbank

FSDP provided support in connection with the potential Armimpex and Arexim Bank transactions involving foreign investors, Troika Dialog and Raiffeisen.¹ This assistance was primarily aimed at collecting, analyzing and packaging information on the Armenian banking sector and in highlighting investment opportunities. FSDP did not perform fact checking or auditing of the target banks; this is not appropriate given FSDP’s or USAID’s mission. Instead we provided highly detailed insight and intelligence on the operations of the sector, the relative competitive positions of the individual banks, possible value adding strategies a new owner could pursue and comparative opportunities. These topics were presented both as of

¹ Troika is interested in acquiring ArmImpex Bank. Raiffeisen is interested in acquiring the remaining 80% of Arexim Bank that it does not already own.



the current date and in time series. In this regard, the Project completed the following: (a) information support to Areximbank on market structure, competitive conditions, and analysis of risk, return and growth in various lending and non-lending sectors (e.g. factoring and leasing) that was used to prepare for initial discussions with Raffaisen Bank; (b) detailed presentations to the due diligence teams in both pending transactions concerning the numerous topics outlined above; and (c) ongoing and ad hoc data collection and analysis tailored to the follow-up requests of the acquiring parties in support of the due diligence process.²

As of the submission date of this Report, the likelihood that one or both of these transactions will be successful is high. The Project received compliments from the foreign investors, the due diligence advisors, and the counterpart banks for its assistance thus far. There has been good communication between the FSDP team and these parties over the quarter, which we believe is a sign that the Project has been adding value to the process.

Support for Inward Investment by Haypost and Partner Investors

In addition to the ongoing transactions of Armimpex and Areximbank, the Project also played a role in the potential Haypost acquisition of a bank or bank network. Of particular interest is Haypost's plan to create (or buy) a bank that will be resident in each of their branch offices. This would create a bank within Armenia having 900 locations – by far the largest geographical coverage.³

The Project had significant interaction with Haypost and one of its major partners this quarter. Some of the key activities involved a due diligence presentation to a group of Haypost staff and managers; a presentation to senior officials of Haypost, who noted that they were significantly impressed with the information provided on Armenia; and a presentation to the CEO of a leading regional bank concern that is also looking to make an investment in Armenia. This latter presentation was requested by Haypost executives on the basis of their appreciation for the quality of information and opportunities presented by FSDP.

All of the presentations went well. Haypost and its partner investor indicated that they will be doing further examination of the market for opportunities. The Project is keeping track of progress and seeking to provide assistance wherever possible to advance closure.

Assistance to Banks on Product Development and Risk Management

We completed the partner bank selection process. The selection criteria and candidate banks results were presented to USAID for approval. On the basis of this selection, the Project started to work with several participating banks on the creation of new products and/or ways to source long-term funds. Some of the key activities are noted below.

- *Areximbank*: We are working with the bank to develop two new funding products and a new credit product: (a) negotiable CD's; (b) middle-term floating rate coupon bonds; and (c) floating rate loans (including mortgages). All of these products, if developed and marketed, will represent an important step to the deepening of the financial sector. They impact both the level of savings mobilization, but also the range funding sources that could enable banks to grow. The development of new CD products would be a major boon for the market since legal barriers, high reserve requirements, and other factors have prevent growth of the intermediate and long-term savings market for years.
- *Armswissbank*: We continued our work with the bank to support the Armenian Copper Program bond issuance of which they are advisor. The final action plan was developed and presented to the bank and ACP sponsor. The preliminary terms and conditions of the debt were drafted in

² The materials selected and submitted by the Project were collected from the Database which now contains over 14 megabytes of information. Topics included macroeconomic indicators, 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.

³ FSDP indicated that the Project has a strong interest in working with Hay Post to develop retail products, exploring the use of securitization of their properties and devising methods to capture the remittances flow that Hay Post Bank will undoubtedly process



cooperation with the bank and presented to ACP (AMD500 million, 18 month, coupon bonds, semiannual payments, 10%). We also provided ad hoc support of a similar nature to the bank in connection with the Valletta underwriting. The Project awaits further word on what additional support will be needed to get this issuance to market. It will remain in contact with the bank and sponsors during July.⁴

- *Unibank:* We designed two new instruments – Gold Certificates and Gold Bonds -- and introduced them to the bank for consideration. Gold Certificates are a completely new instrument, which is certifying the ownership right of the holder of a specified amount of gold. Gold Bonds are floating rate coupon bonds paying an interest rate tied to the market price of gold. Both of these instruments are novel pursuits of funding opportunities that link commodity markets to financial markets and speak to cultural interests. If approved and marketed they would represent an important milestone in product development. FSDP awaits feedback from the bank management and Board. Further support is being planned for other new product ideas.
- *Ararat Bank:* For Ararat Bank, the Project undertook three main initiatives. First, we were able to significantly support the Ararat bond offering, which was a milestone event for the Armenian financial sector. [More on this is provided below under development of alternative financing instruments.] Second, we drafted a preliminary action plan for an IPO of the bank's common shares. The Board rejected the previous idea of convertible bond issuance and decided to issue a small amount of shares in October. The main purpose of the transaction is to reorganize the bank into a public company. This action plan is being reviewed and the outcome of this review will determine the Project's further support in July and thereafter. Third, we spent a total of 12 person hours reviewing the bank's credit scoring system and held two long sessions with the Ararat staff to discuss the details of our recommendations.⁵

Other Work Related to Assistance to Banks

Other work undertaken by the Project that is either related to the above assistance or complimentary was as follows:

- We submitted a model letter of intent (LOI) for financial institutions. This will be the template for the partner bank LOIs that will secure their commitment, cooperation, and resource-sharing for direct technical assistance and training in product development and risk management. This LOI was submitted to USAID for review and approval.
- We also conducted outreach to other banks and UCO's for assistance partnership. We had introductory meetings with Promety Bank, Armenian Development Bank, Anelik Bank, ITB Bank and Agroleasing, a UCO. These meetings were about providing a general framework of what FSDP does, and about exploring possibilities for assistance. The Project has not formally agreed to any assistance for these institutions; their needs and commitment level are unclear. FSDP also held follow up meetings with Converse and Ineco. Despite initial strong indications of interest, these

⁴ It should be noted that in connection with both the ACP and Valletta securities offerings the Project is working with the underwriters and financial advisors rather than the corporate issuers. This reflects our focus on banking issuers and the sensitivity that the Project not crowd out the already existing underwriting and advisory firms. The importance of this work is that it supports Project goals on at least three levels. First, it is supportive of the development of innovative alternative financing instruments that are suited to the local economy. Second, it is supportive of helping the bank to diversify its product and service offerings. Third, and linked to the first two items, it helps to create the essential bridge between a banking institution and the capital markets that facilitates capital formation and movement. The mutual dependency and the interface between institutions and markets is an essential ingredient to a sustainable domestic financial system.

⁵ From this exercise and our interviews with other banks we can see that risk management is a central issue for all of the banks and should be the starting point for our training program. The results of the Global Training Needs Survey will give us a prioritized list of topics but we are sure the risk management will be at or near the top.



banks have not followed-through with the necessary specification of the assistance they request; we expect that they may not become partner banks for the Project.

- With the Mission (J. Caracciola) FSDP met with Ineco Bank to review the term sheet regarding the DCA guarantee of its upcoming issue of bonds. More on this is noted below on the development of alternative financing instruments.

Risk Management Training

We developed a program for and started the risk management training. This training will be provided over next 6-7 months. It will be delivered to the banks as part of an ongoing series of seminars on various elements included in risk management.

The program kicked off with a two day workshop on the Introduction to Principles of Risk Management (June 20-22). There were a total of 52 participants: 49 staff from 14 banks plus 3 faculty members staff from the Russian-American (Slavonic) University. FSDP with support of EMG Home Office have been working on further development of the risk management training curriculum based on the evaluations from the participants on this workshop. Searches are currently underway for different types of risk management specialists who can work with the FSDP banking team to deliver a wide range of training. There is an emphasis on engaging experienced practitioners who will understand the specific challenges being faced by Armenian banks.

We are in discussions with the university with the goal of eventually turning our complete program on risk management over to them for ongoing training on a sustainable basis. The participation of these members of the university was the first step in training the trainers in this regard.

Other Initiatives

We completed the drafting of the new factoring product presentation and made progress on the leasing presentation, which should be completed in July. The purpose of these works will be to raise bank awareness of market opportunities for leasing and factoring, and to solicit interest in FSDP's support to banks interested in developing these products. FSDP is working on organizing and scheduling the delivery of these presentations to be given in July/August.

FSDP made a presentation, and otherwise participated in, LPGs3's roundtable on Lending to the Municipalities (June 25). FSDP will continue to work with LPG3 in this area whenever FSDP can add value to LPG3's work. The participants in the workshop included representatives of 14 different municipalities and 11 representatives from 6 commercial banks (Cascade, VTB, Ardshininvest, Converse, ACBA, and Arexim Banks) and 1 UCO (Agroleasing). FSDP assisted in arranging for the participation of a number of these banks and the UCO.

MORTGAGE MARKET DEVELOPMENT

After a relatively sustained period of discussions with KfW on the joint roles of the two projects and coordination, it was agreed that FSDP will focus on secondary mortgage market issues and that KfW would continue its focus on primary issuance markets. The outcome of this agreement will mean that, for now, the Project will not undertake work on the standardization measures that are in the work plan. This does not mean that the Project will not eventually undertake such work – the KfW Project has a much shorter lifespan and it is unclear at this stage how much will get done under that project. Nevertheless, for the immediate future, work will focus on secondary market development and overall support for mortgage development through improved access to credit, insurance product development, etc.

Our involvement in the mortgage area during the quarter continued to focus on the legal and regulatory framework for the secondary mortgage market. But new inroads were also made on the credit reporting side, which could make access to credit easier, and on the development of title insurance which is supportive of market development.

On the legal and regulatory side, Project activities covered laws on securitization, mortgage bonds, and asset backed securities. More on this is covered under Component 3, Legal Reforms.



Progress on the credit reporting work is noted under Component 3, Information Sharing, and progress on title insurance is noted below under insurance industry development. We established a working relationship with the mortgage association, which will be helpful for gaining support among bankers and the CBA for changes in credit reporting formats. We also attended the Mortgage Market Participants Association MQS Roundtable. This was a discussion of the requirements developed by KfW under their mortgage project and the application of the MQS to the lending to be refunded by the KfW line of credit program.

Finally, we met with Edward Yacobov on mortgage technical assistant to be provided by the IFC. The main point of the meeting was for FSDP to: (a) provide information to the IFC on what was being done; (b) help to identify where the gaps of assistance remain; and (c) to provide input and feedback on ideas related to a new project that the IFC wishes to develop.

IMPROVED INSURANCE INDUSTRY

New activities were started this quarter to develop a role for the Project in supporting insurance development – legal, regulatory, product development, data development and technical assistance partnership searches were all part of the mix.

Assistance to Insurance Companies

The Project is working to identify potential technical assistance partners. Earlier in the quarter, we held a presentation for all Armenian insurance companies and brokers to introduce FSDP and its technical assistance program. We met with the Executive Director of new Insurance Association in order to gauge the appetite for working with the FSDP. She was to canvass members and provide her views on where the Project may assist. Based on the outcome of these discussions, it is clear that finding partnerships and getting buy-in from insurers may take time. The current environment is also belied by a cautious regulatory environment where the immediate focus seems to be on contraction rather than growth. We are optimistic that technical assistance agreements can be arranged, but we are still waiting for feedback from the insurance association on the Project's proposals.

Product Development

FSDP started to design a new special insurance product – “real estate title insurance” -- for insurers. The users and beneficiaries of this special insurance product should be banks and credit organizations who are in the business of mortgage lending. Title insurance enables lenders and property buyers greater security and as a result should help facilitate mortgage lending. The utility of this product will depend on its pricing; *i.e.*, the additional transactional costs should not be prohibitive.

Statistics Center

The CBA created a new Statistics Center as a separate department of the central bank. The concept is to draw on the data sources already existing in the country, create new information gathering systems and consolidate this process. Then – in a plan somewhat like the consolidated regulator – spin this Center off after it reaches sustainability. The FSDP is providing TA and possible financial assistance to the Center. This work in the early stages, but the Project has begun research in order to assist CBA to set this center up.

Regulatory Strengthening

On regulatory strengthening, FSDP started to work with the insurance supervision division and is still reviewing new laws and regulations. More on this work is covered under Component 2 and Component 3.

Actuarial Capacity Building

FSDP participated in the opening ceremony of sub-faculty “Actuary Mathematics” at the Yerevan State University.⁶ There was strong demand and agreement for developing an actuarial profession. The CBA has

⁶ The Chairman of CBA (Tigran Sargsyan), Minister of Social Affairs (Agvan Vardanyan), representative of USAID (Volodimir Yatsenko) and others provided remarks for the press. They all emphasized the importance of having well-educated and trained actuaries and underlined their roles in insurance and pension industries.



submitted a request for the Project to provide support for the development of an actuarial certification program.

On the basis of this, FSDP started to work on planning technical assistance for the area. In conjunction with EMG Home Office, recruiting has commenced for a qualified actuary to provide assistance. Further talks with the CBA have indicated that the certification capacity should come from an international organization; therefore the Project started to review various international organizations and to strategize on how to coordinate the building of domestic capacity.

This work will gear up in subsequent months. Actuarial capacity is essential for development of the domestic industry because companies must have the ability to price and underwrite insurance in ways that are safe and sound. Up to now, because such a high ratio of insurance is ceded to reinsurance companies out of country and the limited product range insurers could get by in not having that capacity. The Project views this activity, along with the CBA, as part of the critical path for industry development.

MANDATORY AND VOLUNTARY PENSION SCHEMES

FSDP continued to participate in working group activities⁷ and to meet with USAID/FSDP/SPSS Pension Committee to coordinate activities and exchange ideas.⁸ The Project reviewed the Action Plan of Pension Reform within the Thematic Working Groups 2 and 3, participated in numerous meetings and discussions, reviewed and commented upon numerous documents and provided recommendations on various regulatory and supervisory issues. It worked on preparing recommendations for the development of a pension reform strategy.

Some progress is being made, but policy decisions are proceeding slowly. Separately, FSDP is providing ongoing support to the CBA in addressing securities market reform, which includes among other things, regulation of investment funds and asset managers that are relevant for Pillar II/Pillar III reforms.

The main activities during the quarter were as follows:

- We submitted a document entitled “Approaches on Pension Fund Investment Regulation” to the Pension Reform Working Group as well as to all thematic group participants. This document presented the essence of qualitative and quantitative restrictions for pension assets investments in general, summarized corresponding data from OECD countries experience and provided some recommendations on possible solutions for the case of Armenia.
- We reviewed and commented upon extensive documentation prepared by other participants such as SPSS and the World Bank
- We attended a presentation on the PROST results. These will be important when we begin to model the business side of Pillar II in expectation of providing advice on structure. The layout of Pillar II and the design choices made will essentially revolve around the projected size and growth over time. This dictates what revenue streams can be expected and impacts what costs can be carried by the system. The demographics identified by PROST will help determine levels of participation. Then we can plug in other expected business costs to see what diagram is economically feasible for the Pillar II. This in turn will drive a decision on the benefits the State can provide.
- We participated at a workshop in Tsakhkadzor 15-16 May 2007
- On May 24th Richard Webb gave a presentation to the Pension Reform Working Group on “annuities” which also covered payout schemes for Pillar II activities (including lump sum withdrawals, staged withdrawals, and annuities) and associated issues.

⁷ In April alone FSDP participated in six (6) meetings of the Pension Working Group and two (2) of the Thematic Sub-Groups. In addition, we met privately with the CBA to discuss additional contributions to the Pension Working Group, and to discuss pension-related issues.

⁸ This Committee meets on a bi-weekly basis to ensure harmonization and avoid duplication between the two projects)



- Also on May 24th, the COP gave a presentation to the Pension Reform Working Group on the Armenian Financial Sector and its role in Pillar II activities. Both of these presentations helped to elevate the working group's understanding of key pension elements.
- The Project sent 5 persons (including 2 Project staff) to the International Federation of Pension Funds Administrators (FIAP) Conference in Varna, Bulgaria, from 31 May to 1 June. This event focused on policy and implementation issues for multi-pillar pension systems. The knowledge shared will help Armenia learn from the lessons of Bulgaria and other markets.
- We met with World Bank (Guillermo Lorrain) visiting mission on pension issues. In addition to the workshop and action plan issues noted above, the Project also had discussions and provided input on issues related to investment grade instruments, investment restrictions, rule of law, hedging, and foreign investment. These discussions are ongoing and we suspect further consultations will be held in July.
- FSDP attended the Pension Working Group conference held June 18th and 19th at the CBA where the "whitepaper" entitled "Pension Reform Strategy" was critiqued.

The culmination of these activities is enabling the Project to contribute the pension reform work and keep an active focus on developments that will impact Pillar II/III development, in particular. It is also supportive of the insurance development work and the development of an institutional investor base that will eventually be the source of demand for long-term non-bank financial instruments.

It is expected that in the next quarter FSDP will conduct an econometric analysis of a proposed Pillar II system that will provide valuable information for the reform of the Pillar I system. This analysis will be conducted by a qualified actuary who will review various economic and demographic scenarios and their impact on the proposed reforms. In this regard, the SPSS Project has agreed to share their projections and data in order to not duplicate effort.

DEVELOPMENT OF ALTERNATIVE FINANCING SCHEMES

There are multiple streams of work in this area, which are contributory to deepening of the sector.

Support for DCA Credit

With the Mission (J. Caracciola) FSDP met with Ineco Bank to review the term sheet regarding the DCA guarantee of its upcoming issue of bonds. These are planned to be "annuity bonds", paying interest on a coupon basis with a portion of principal also returned. Thus, they are the Armenian equivalent of "amortized bonds" in the US. We also provided written comments to the term sheet.

Assistance to Ararat Bank in Connection with its Bond Offering

In an event highly significant for Ararat Bank and the future the debt markets in Armenia, the bank completed its coupon bond offering. The underwriting took place from May 3rd through May 10th, with 250 mln Dram issued. Subsequently, the bonds were successfully registered in the Armex for trading and placed on the listed tier of the stock exchange.

This transaction is important for the development of the debt markets and the banks' ability to source long-term capital in several respects. First, it is the first ever issuance of coupon bonds in the country. Second, the underwriting was oversubscribed at 263 mln Dram, indicating strong interest. Third, the bonds received a rating of "A", the highest possible. Fourth, Ararat Bank is the only issuer with "A" rated bonds outstanding. Thus this transaction should have strong demonstration effect for other financial institutions and nonbank issuers⁹. The Project provided various support to the bank related to credit review and terms review.

⁹ The offering of this new type of bond opens the door to longer-term debt issuances. By offering a bond format that pays interest on a periodic basis (in this case quarterly) setting the maturity of the debt becomes only a question of what the market will bear. In contrast, the discount format previously issued in Armenia can only be used for short-term issues. By solving the mechanical problems of making periodic payments and introducing a bond that is sold at or near face amount and pays interest during the



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Bank Bond Offerings and Other

In light of the success of the Ararat Bank bond offering in May several banks have expressed interest in finding new ways to source long-term funds.

FSDP hosted a roundtable discussion entitled “Market Sources of Long-term Funding for Financial Institutions.” The event had over 53 registered attendees. 6 speakers made presentations on a variety of related topics. We also created and distributed two brochures (FSDP’s Capacities and 10 FAQ Relating to Bonds). These efforts are meant to build momentum from the Ararat Bank issue, and provide a basis for the Project to assist other banks. Further, in the interest of creating longer-term sources of funding, these offerings are an opportunity for the Project to help change the funding and investing structure of banks.

For the participating banks, we also began work on floating rate, middle-term bonds, new certificates of deposit products and an IPO of one bank’s common shares. Some of this work is outlined above under “Assistance to Banks”

Municipal Finance

We commenced some exploratory work in the area of municipal finance. The Project met with the Local Government Project to explore ways the projects could cooperate to enhance credit to municipalities.

As a follow-up to this meeting, the FSDP (John Fitzgerald) made a presentation, and participated in, LPGs3’s roundtable on Lending to the Municipalities (June 25). The participants in the workshop included representatives of 14 different municipalities and 11 representatives from 6 commercial banks FSDP assisted in arranging for the participation of a number of these banks and the UCO. We will continue to work with LPG3 in this area whenever FSDP can add value to LPG3’s work.

OMX and ArmEx Merger Discussions

Support to the CBA on OMX-ArmEx merger this quarter involved different activities. They include the following:

- We reviewed and significantly restructured the Letter of Intent relating to OMX’s acquisition of the Armenian Stock Exchange and Central Depository of Armenia. Our version was signed on April 27th between the OMX and the CBA. The next step is to for the parties to perform certain conditions precedent to the signing of the Purchase and Sale Agreement..
- We prepared a comparison report detailing the upgrades and updates of the RTS software necessary to bring it in line with the Moscow version. This was submitted to the CBA on May 21st.
- We prepared a survey and inventory of the hardware in use by the ArmEx. This will be used by the CBA in negotiating the extent of the revision of the technology prior to OMX acquisition.
- We participated in a press conference sponsored by the CBA on the OMX-ArmEx deal. The Project’s participation in this conference was to reinforce that the FSDP is willing to discuss how it can help close this transaction. In this regard, the Project’s commitment is only to be ready for future talks and possible TA. In private the FSDP has made clear to the CBA and OMX that it is not willing to provide direct or indirect financial assistance to the merger.

These activities provided objective third-party input for the discussions and helped to widen the base of knowledge about what will be needed by each party in order to make a deal attractive. While these activities were relevant for the ongoing discussions, they were also useful for the FSDP’s knowledge in so far as it will help to define where assistance may be given to the stock exchange directly, in terms of technical assistance.

life of the bond, longer term maturities such as “coupon bonds” (interest only in periodic payments) and “annuity bonds” (interest and principal included in the periodic payment) become possible.



OTHER SUPPORT RELATED TO STRENGTHENING INTERMEDIATION

We met with Roger Bird, Credit Advisor to the new MCA Water to Market Project to provide information on bank operations. This was to assist the credit advisor in setting the eligibility parameters for approved lenders in the MCC's water to market program. The Project subsequently provided him with data on the banking sector and UCOs. While there does not appear to be significant overlap between the MCA and FSDP we will maintain an open line of communication and re-assess opportunities for cooperation.

COMPONENT II: SUPERVISION

BASELINE ASSESSMENTS

We completed the international standards assessments for banking and securities. The Basel Assessment was submitted on June 22, 2007. The IOSCO Report was filed on July 19th (after the close of the reporting period). As of the date of this Report the fieldwork for the insurance regulation assessment was underway.

These assessments will be used in two ways. First, they will be used to establish the baseline level of compliance that will be used in the Project's Performance Monitoring Plan. Second, as they contain valuable information and recommendations for reform; they will be used to establish a reform and technical assistance support plan for discussion with CBA.

UNIFIED SUPERVISION

As noted in the February Report and the Q2 2007 report, FSDP provided STTA to assist the CBA in identifying and implementing a new organizational model. This work produced four models for consideration. In April the CBA chose to pursue "option #3" which combines functional roles over the various subject matters overseen by the CBA.

Following this decision, during the quarter, we were asked to provide follow up assistance by addressing a number of questions posed by the CBA on its new structure. Responses to these various questions were outlined in a 20-page brief that was delivered to the CBA under a technical assistance assignment conducted June 6th through June 16th. The issues addressed in this brief covered the organization of licensing, consumer protection alternatives, and terms of reference for various departments such as external relations, supervisory evaluation and peer review, and supervisory methodology.

The CBA has indicated that it will have completed the staff reorganization by the end of July. Following that, we will engage the CBA to discuss the next stages of work on process and methodology.

RISK-BASED AND CONSOLIDATED SUPERVISION

During the June STTA, FSDP met with the CBA to discuss movement towards Risk-Based Supervision. The Project is ready to provide assistance, but the CBA's time-line may be farther out than anticipated. In order to generate some momentum on this initiative, we have offered to provide a presentation to the CBA on how RBS can/should be implemented in a unified regulator, and how to apply RBS to insurance and securities firms. We are awaiting feedback from the CBA on this suggestion. It is hoped that a presentation could be made at the end of July during an STTA visit by Mr. Sinclair. Given the vacation schedule however, this may well occur in September.

PENSION FUND SUPERVISION

We continue to participate in various discussions with the USAID SPSS project about each project's respective role. However, this is still under evaluation by the CBA, MoF and Ministry of Labor and Social Affairs.

We provided a cover memorandum and finalized comments on the document "Approaches to Pension Fund Investment Regulation." This document is to be used to influence the development of the regulatory structure for Pillar II/III pension funds.



While regulatory issues are part of the reform discussions, the institutional decisions about how and who will regulate pensions remain undecided. FSDP will continue to support the decision-making process, but until those decisions are made the Project's work will likely be focused on legal review and on high-level policy analysis.

OTHER NEAR-TERM ACTIVITIES IN ENHANCING FINANCIAL SUPERVISION

Support to CBA on OMX-ArmEx Merger

Support to the CBA on OMX-ArmEx merger this quarter involved different activities, but none were directly relevant for enhanced supervision. FSDP activities in this regard are described under Component 1 above.

Strengthened Insurance Supervision

On regulatory strengthening, we started to work with the insurance supervision staff of the CBA to understand how they function, to introduce the FSDP to, and explore ways of obtaining information about the insurance industry and industry participants. We agreed that the Project should provide support in a number of areas.

One of the first areas the Project will lend support in is the development of a prudential risk rating model - CAMELS. This system is an international insurance-rating tool by means of which the insurance undertaking's supervisory authorities rate institutions according to eight factors. It is based on the same approach as used by the CAMEL rating system for banks. It is a first step to the implementation of risk-based supervision and it will help strengthen the quality of analysis of insurance companies.

Other Support to CBA

Additional areas of support to the CBA include the following:

- During April, FSDP sponsored two members of the CBA staff to attend the US SEC's 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. It provides an opportunity for participants to learn from those most knowledgeable in the US and from one another the different ways in which to achieve these goals. The overall report from the persons attending was highly positive.
- We completed a report on the tax situation for a range of intermediation and investment activities. This activity is supportive of investment promotion and increasing interest by the CBA and MoFE to strengthen the incentives for innovation. It directly supports the work the Project will be doing in helping the CBA to develop a balanced approach to regulation that focuses on both risk and industry development.
- We continued research on the experience of foreign countries in setting the general criteria for sanctions determination and procedures of enforcement. This is follow-on work related to the enforcement advisory assistance being provided by the project.

FRAMEWORK FOR FIGHTING MONEY LAUNDERING, TERRORIST FINANCING & CORRUPTION

No specific activities were undertaken this quarter. FSDP is awaiting an opportunity to coordinate with the CBA and UBA on proposed training for banks. Risk management training for banks commenced and it is possible that once the major modules have been delivered some of the AML training can be provided.



COMPONENT III: INFRASTRUCTURE

LEGAL REFORMS

Banking

FSDP received from the CBA three drafts of Laws: “Truth in Savings”, “On Consumer Credit” and “On Financial System Ombudsman” for review. FSDP commenced its review and submitted our comments and recommendations to CBA on July 13th (after the close of the reporting period).

Securities

In the Securities area, we focused on legal and regulatory and infrastructure issues.

- FSDP provided recommendations regarding the draft regulation #42 on “Capital Requirements for Professional Participants of Securities Market” for the CBA.
- We provided comments on the draft version of IOSCO Principles Assessment Report prepared by Kathryn Trkla.
- We provided finalized comments on 1st and 2nd editions of the draft of Law on Securities Market.

Insurance

FSDP submitted comments and recommendation on the draft Insurance Law. This submission was a finalized version of a submission that had been in preparation for two months. While the FSDP’s involvement in reviewing this law came at a very advanced stage of legal development, it is the Project’s hope that the substantial comments and recommendations will influence final revisions and parliamentary review of the draft, and perhaps be used as a resource for subsequent development of subsidiary regulations.

Mortgages

FSDP received various editions of the draft “Law on Securitization and Asset Backed Securities” and “Law on Covered Mortgage Bands”. We reviewed the drafts and submitted comments and recommendations to CBA. Thus far, the CBA have accepted most of the recommendations. As at the writing of this report we are awaiting the revised versions of the laws for further review. The CBA have indicated they should be ready in July.

Credit Reporting

FSDP will be undertaking some legislative support for credit reporting. Refer to Information Sharing below.

INFORMATION SHARING

Assistance to the Credit Bureau:

Important developments came about this quarter regarding the credit reporting work.

The CBA asked the Project to provide assistance in creating a draft Law on Credit Bureaus. In conjunction with EMG Home Office, the Project team prepared a scope of work for the assistance, and contacts with various potential credit reporting advisors have started. It appears that this STTA will focus on commenting on a draft prepared jointly by the CBA and FSDP staffs, based on international best practices.

We received and revised the proposal from ACRA for assistance. Based on this letter, and other meetings during the month, FSDP drafted a Joint action Plan, including a timetable, for cooperation with ACRA in terms of three main areas: a) hardware and software development and upgrades, b) credit scoring system



development and c) legal issues. Additionally, the Project prepared a memo covering ongoing and completed activities with ACRA.

We also had several joint discussions with AMMPA, ACRA, banks, and various IT specialists and programmers to review the technical feasibility of collecting and processing information on mortgage loans. We studied the technical capacities of the current banking software and the possibility for sending the information to AMMPA and/or ACRA for the AMMPA proposed database creation. We communicated the results of this review to the CBA and requested that the CBA Statistical Department and Credit Registry outline their needs for possible FSDP assistance. It was agreed that the CBA and ACRA will need to sort out their respective complimentary roles first before any assistance package is set. In this way a consolidated scope of project assistance can be developed. The Project is waiting for this feedback from the CBA and ACRA.

Assistance to the Mortgage Association and ACRA

We had several meetings and phone discussions with AMMPA on their institutional development challenges, needs for training, data resources and web site. It was agreed that the best way to collect and process information for AMMPA is the ACRA system. However, the central challenge at this point is that ACRA lacks the proper systems and hardware to accommodate the AMMPA and to get its full endorsement. There are challenges with both the system (using Excel is not a sustainable or secure approach), and the quality of data. On the basis discussion with AMMPA, and in order to get things moving, we prepared a draft joint action plan for assistance and cooperation that incorporates the joint ACRA/CBA work noted above as well as specific assistance to AMMPA vis-à-vis its members. This plan is being reviewed by the COP and EMG Home Office.

Support to AMMPA creates an important synergy for the work of the project in terms of support for overall credit reporting development, but in particular support that also helps development of the mortgage market.

Accounting and Auditing Standards

We undertook an expanded level of activity to improve the quality and reliability of financial reporting in ways that will support access to credit and improve the environment for private sector development. The Project has started to work with the MoFE, MoJ, and the AAAA on the translation of international accounting and auditing standards.

Good progress was made this quarter on implementing this translation work. The following are the major developments:

- We worked with the MoFE and MoJ to clarify the legal situation and solicit their support regarding the IFRS adoption in Armenia. On this topic, we drafted a memo covering the key issues, reviewed analogous EU experience and identified the key divergences between adoption of the official IFRS procedures designed by IASB and IFRS to the adoption procedures used in the EU. We also submitted a corresponding letter to MoFE to clarify their views on our summary about existing legal environment.
- We finalized the Letter of Intent, stating the responsibilities of both FSDP and MoFE for the translation work and national adoption of IFRS. This was submitted to USAID for review and approval.
- We finalized the official translation procedures
- We itemized the standards to be translated. In this regard we coordinated with the AAAA, IAB Center, GT Amiot and MoFE.
- We finalized the team structure
- We finalized the action plan for translation and adoption of IFRS.
- We reached out to IASB to obtain its guidance on the translation procedures.



The next stage of work will be to execute an agreement between the MoFE and IASC, including copyright waiver for the translated documents, engage a translation coordinator, and commence the translation work. It is anticipated that this will commence next quarter.

CORPORATE GOVERNANCE

The results of the IFC's review of corporate governance at banks, which was conducted in 2006, is useful but it does not cover some of the areas that are relevant for FSDP's work or for the regulatory work that will be undertaken. For this reason, it was decided that the Project should conduct a supplementary review of corporate governance practices across the banking sector where the focus of this review is on practice and systems in relation to CBA requirements and best practice.

- The methodology and scope of this survey has been finalized, and the survey is ready to be conducted. Although EMG Home Office had been working in conjunction with the FSDP team to arrange for AIPRG to undertake this study it was determined after the close of the reporting period to open the task to other vendors. After a limited solicitation, AFIC has been selected and is performing the work under a Purchase Order.
- FSDP prepared a set of presentation materials for UBA and CBA in connection with the Project's review of corporate governance activities. These will be used in the kick-off meeting to be held at the CBA for the commencement of the survey.
- Other supporting activities include the following: (a) a preliminary review of corporate governance-related documents provided by 15 banks; (b) creation of a draft list of output tables for the corporate governance assessment; and (c) development of a set of indicators that will allow assessment against and comparison between OECD, Basel II principles, and current Armenian banking legislation.
- Finally, FSDP started the drafting work on the corporate governance manual.

PROFESSIONAL EDUCATION, TRAINING, AND OTHER CAPACITY BUILDING INTERVENTIONS

General Public Survey

There is insufficient research and intelligence on the public use and perceptions of the financial sector. Penetration and utilization ratios are very low, and the reasons are not well studied. In order for the project to tailor assistance to help improve the depth and breadth of financial services, it is necessary to understand what some of the barriers on the demand side are. To that end, FSDP has undertaken an initiative to survey and study the financial sector from the users' point of view. This study will canvass between 3,000 to 4,000 consumers in various towns and areas of Armenia to understand their needs and perceptions and various consumption patterns.

The methodology and assessment framework for this public survey is ready. Most of the work on the preparation of the general public survey this quarter centered on getting AIPRG contracted and organized to carry out the study. This is taking longer than expected. However FSDP and EMG Home Office are working to assist AIPRG in the administration and setup for this activity. It is everyone's hope that the study will commence in July.

Remittances

In order to advance the development of remittance-based products, FSDP has undertaken to conduct some additional remittance based research. This research will compliment USAID's previous work and help the project and various banks understand if there are opportunities to develop remittance-based products.

The design of this research is ready. As at the end of this period, materials are being reviewed by the COP and EMG Home Office, and once finalized will be presented to USAID for discussion.



Training Needs Assessment

In order to develop appropriate training for market participants and to facilitate growth in professional training capacity, FSDP has undertaken to conduct a comprehensive review of both the training needs of local professionals, and of the existing infrastructure for training. This study will be carried out by VGM.

The methodology and assessment framework for the assessment is ready. We anticipate that implementation work will commence soon.

SUMMARY OF PROJECT WORK BY INDUSTRY

A table providing a summary of FSDP activities and results by industry is provided in Appendix A.

DELIVERABLES

The following deliverables were presented during Q2 2007 and are attached to this Report as Items A through P:

Deliverables for April

- A. Presentation to AmCham.
- B. Comments to Ineco Bank DCA bond guarantee.
- C. Revised Letter of Intent between CBA and OMX. Please note this document is confidential.

Deliverables for May

- D. Guidelines on Factors for Sanction Determination for Violation of Banking Laws and Regulations
- E. Report on Banking Law Violations and Corresponding Punitive and Curative Sanctions Designed by the Armenian Legislation.
- F. Comments to CBA on Draft Regulation No 40 on Securities Registration Statement and Reports of Reporting Issuers
- G. Comments to CBA on Package of Amendments Relating to 5 Separate Laws
- H. Comments to CBA on Proposed Capital Adequacy Rules – Regulation #42
- I. Comments to CBA on (1) Law on Securitization and (2) Law on Covered Bonds
- J. Comments to CBA on Recently Enacted Insurance Law and Related Amendments to the Civil Code

Deliverables for June

- K. Questions from CBA Related to Re-Organization. June 14th
- L. Assessment of Basel Core Principles Compliance for Effective Banking Supervision. June 15th
- M. Introduction to Risk Management; Presentation Materials. June 20-21.
- N. Due Diligence Presentation June 13th Ameria
- O. Due Diligence Presentations June 15th and 19th Hay Post
- P. Due Diligence Materials Arexeim Bank



SUMMARY OF EXPECTED ACTIVITIES NEXT MONTH

Below is a summary of some of the main activities that the Project will likely undertake in the next month. These activities are based on the visibility of the FSDP Project Team and EMG Home Office as at the time of drafting this Report. This list is not all-inclusive in so far as it is only meant to capture the major streams of work.

COMPONENT I - INTERMEDIATION

Banking

- FSDP will conduct follow up activities with the partner banks. These activities will focus on the following.
 - Ararat bank:* Terms and conditions of issuance of shares. Preparation of IPO;
 - Unibank:* Internal discussions and approvals on Gold Certificate issuance;
 - Areximbank:* Internal discussions and approvals on issuance of Certificate of Deposits;
 - Armswissbank:* Internal approvals of Bond issuance by ACP, Underwriting agreement between the Bank and ACP (firm commitment).
- On July 6th, we will conduct a one day presentation for the commercial banks on factoring as a new product. This will be held at the FSDP office.
- July 17-19, FSDP are planning to hold a 3 day (3 hrs a day) workshop for the commercial banks on Market Risk Management. We will use STTA for this workshop. In addition to the workshop, meetings will be held by the STTA trainer and FSDP staff with some participants in the workshop for more detailed discussion of the current status of the management in market risk in their banks and meetings will also be held by the trainer and FSDP staff with some CEOs to discuss with them the status of development of a Risk Management System, encompassing all areas of risk (Market, Credit, Liquidity, Operational and Business) within these banks. The purpose of these meetings with CEOs is two-fold: to increase awareness within the banks of this important aspect of management and also to try and identify those banks interested in partnering with FSDP to develop such a system based on their bank's needs. CBA and the Russian-Armenian (Slavonic) University will be invited to send participants to this workshop as well.
- FSDP will complete the Leasing product development material in July and plan to schedule a workshop on this product in September.
- FSDP work will also begin organizing the Credit Risk Management workshop which is scheduled to be held in September.

Insurance

- Continue work on development of the Insurance Sector Database
- Efforts will focus on the design and introduction of a new insurance product - "Real Estate Title Insurance". The users and beneficiaries of this special insurance product should be a banks and credit organizations in framework of their mortgage activities.
- FSDP will be gearing up work on and discussions with the Insurance Association. One aspect of this work will be to prepare a summary of existing technical problems faced by the association to improve the quality of their activities and services.

Mortgages

- Coordinate and finalize the joint action plan of cooperation between AMMPA and FSDP.
- Draft an inventory list for the Mortgage Market Database and finalize according to the comments of FSDP and other stakeholders.



COMPONENT II – SUPERVISION

Unified Regulation

- It is anticipated that FSDP may provide further ad hoc support to the CBA on additional issues related to reorganization.

Risk-based Supervision

- FSDP will try to advance discussions with the CBA on the risk-based supervision work under plan. It is hoped that a presentation on the framework for RBS and an operating framework termed “Supervisory Cycle” can be introduced and that will serve as a basis for continued technical assistance.

Pension Regulation

- FSDP will participate in ongoing discussions with SPSS and the pension reform working group to address related issues.
- Ongoing review of new securities legislation will factor in pension management issue.

Other Regulatory Strengthening

- Work will continue on reviewing draft laws and regulations in accordance with CBA’s development agenda
- Work will continue on responding to questions and issues related to supervision in any and all sectors – in particular securities and insurance.

COMPONENT III - INFRASTRUCTURE

Legal Reform

- FSDP will advance work on reviewing the package of laws on consumer protection provided by the CBA. It is anticipated that review of some of these laws will be completed by end of month.
- FSDP will likely be asked to review and provide comments to the CBA’s new draft law that aims to regulate enforcement procedures. (This activity is depending on CBA’s timeline)
- Prepare detailed summary of needs of Insurance Association in hardware and software.

Information Sharing

- FSDP will commence work on reviewing of the Draft Law on Credit Bureaus and it will continue its discussions with CBA, ACRA and the mortgage association on the reform of the reporting infrastructure.

Research

- The technical and financial proposals for Global Training Needs Survey should be completed with the VGM and FSDP should start working on the training needs assessment
- The corporate governance survey should be started
- Work on the General Public Survey may start; however, the timing of this is dependent on AIPRG’s turnaround and compliance with contracting requirements, and the eventual timing of approvals by USAID.
- A final scope of work and specifications for remittances research should be ready for presentation and discussion with USAID.



COORDINATION AND COLABORATION WITH GOA, OTHER USAID PROGRAMS AND DONORS

Coordination with USAID and US Government Sponsored Programs

- The training at the US SEC commenced and included the FSDP-sponsored participation of 5 CBA staff in April. Feedback from the training was very positive.
- FSDP consulted with the local MCC team on the status of the banking system and selected bank operations. This activity was mostly a courtesy to MCC, but it could also support the eventual extension of credit facilities to selected banks and/or the emergence of new financing opportunities that would support the Projects overall credit expansion goals.
- The Project continued to meet with the SPSS team to discuss joint and complimentary activities on pension reform.
- The project provided support in relation to the Development Credit Authority's (DCA) guarantee deal with Ineco Bank.
- FSDP met with the Local Government Project to explore ways the projects could cooperate to enhance credit to municipalities. We also supported an event sponsored by LPG3 matching the demand side (municipal borrowers) to the supply side (interested banks).

Coordination with Other Donors, GOA branches, and Organizations

- The Project met with the IFC to provide insight and ideas on the mortgage system. This activity was supportive of helping the IFC to examine whether it will develop a new mortgage-support activity.
- The Project met with a visiting World Bank expert on accounting and auditing in connection with an upcoming ROSC review and a World Bank mission representative on pension regulation.
- The project continued to work with KfW on division of labor on primary and secondary mortgage market activities
- The project had several interactions with the Ministry of Finance, the Ministry of Justice and the Armenia Accounting Association in connection with the accounting standards translation work
- The project had discussions with the International Accounting Standards Board in connection with the accounting standards translation work



PROJECT MANAGEMENT, STAFFING, MONITORING AND EVALUATION

Work Plan

A final revised draft of the work plan was submitted. This revision responded to several questions, comments, and requests for clarifications posed by USAID.

Monitoring and Evaluation Plan

The FSDP has an indicative 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, but the state of the market has changed a bit. To adjust for this EMG was given an opportunity to revisit the PMP to fit it to the current situation in country and in the field.

This fine tuning process is being completed, based on additional recent discussions held with USAID. It is expected that a fully revised PMP, as well as an accompanying report describing the PMP and how it will be implemented, will be submitted to USAID in July.

Project Staffing

Local and international staffing is essentially complete. The following people were engaged during the quarter.

Staff Recruited During Quarter

Name	Function	Team
Narine Melikyan	Corporate Governance	Team 3: Infrastructure
Samvel Sahakyan	Financial Research	Team 3: Infrastructure
Nora Hakobyan	Finance Manager	Administration
Arthur Khalatyan	PR/PE Specialist	Administration
Mariam Andreasyan	Receptionist	Administration
Margaret Terzyan	Receptionist	Administration
Sergey Vardanyan	Attorney - Advisor	Team 2: Supervision

The COP with the EMG Home Office will continually evaluate the staffing structure in relation to the needs of the project.

Project Publicity

We realize that the successes earned by the Project thus far need to be publicized and leveraged to enable the project secure the best counterpart cooperation possible. To this end, publicity efforts will be geared up in future periods. FSDP will work with EMG Home Office to propose ways of strengthening the publicity impact of the project.

WEBSITE

The Project’s web hosting has been established and the architecture for the site finished at: www.fsdp.am. Work on populating this website was scaled up with the recruitment of Arthur Khalatyan last month.

PRESS COVERAGE

FSDP participated in the press conference held by the CBA on the ongoing OMX-ArmEx discussions.



OTHER

FSDP drafted a cable on the Armenian Banking system for use by USAID and the State Department. The purpose of this cable was to report on the progress that has been made in the development of the Armenian financial sector, but also to underscore the critical need for continued assistance towards development.

A brief report on the project contributions to milestone bond offerings was also drafted and submitted to USAID during the month.

OUTSTANDING ISSUES AND CONCERNS

Project Reporting and Performance Monitoring

It has become clear that the level of qualified resources under the current project structure may be insufficient to address the reporting, work planning and monitoring requirements for the Project. The additional (monthly) reporting requirements, the level of local administrative work related to work planning and monitoring, and, fortuitously, the multitude of technical assistance opportunities in the Armenian market at present, has created an imbalance between the level of resources and the level of effort needed to address both technical and administrative work in the field. It has created additional work load pressures on the COP, and by extension the local team, that may not be sustainable to ensure consistent project performance.

It is our preference not to alter the balance and flow that is currently setting in among the technical teams, or compromise project performance in the pro-reform Armenian environment, by imposing additional administrative or reporting burden. Instead, we would prefer to allow the technical teams to focus on the opportunities they have since the teaming structure of the project was constructed to maximize effort on technical delivery and counterpart interactions. In this light, we believe it may be necessary in the near future to construct a modest change in the staffing structure – and potentially introduce a contract modification – to accommodate a reporting and monitoring professional or even a DCOP who can take some of the tasks away from the COP. This position would likely undertake to coordinate and prepare all of the progress reports, data and information collection requirements of performance monitoring, some administrative work, and potentially also undertake addition publicity and external outreach work such as preparing project bulletins, cables, etc.

For most of this quarter, EMG Home Office and the Technical Director have taken an increased role in assisting the reporting and work planning, and this support will continue for the immediate future. However, this support is only part of the support that will likely be needed in the future as the project grows; there will be a need for a constant presence in the field.

The Project, in conjunction with EMG Home Office, will prepare a proposal and a set of options in the coming quarter that will address this need, subject to USAID concurrence.



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APPENDICES AND ATTACHMENTS

APPENDIX A

	INTERMEDIATION	SUPERVISION	INFRASTRUCTURE
BANKS	<p><u>Database and Analysis</u></p> <ul style="list-style-type: none"> • Presentation to AmCham • Presentation to final pool of banks • Information upgrades • Expansion to include UCO's and non-banks <p><u>Investment Promotion</u></p> <ul style="list-style-type: none"> • Due diligence support to Arimpex • Due diligence support to Areximbank • Inward investment support to Haypost <p><u>Product Development</u></p> <ul style="list-style-type: none"> • Areximbank: new CD products • Armswssbank: ACP bond issuance and Valleta underwriting • Unibank: Gold Certificates and Gold Bonds • Ararat Bank: Bond offering support, actions plan for IPO of shares, credit scoring review <p><u>Risk Management Training</u></p> <ul style="list-style-type: none"> • Bank training commenced <p><u>Other</u></p> <ul style="list-style-type: none"> • Factoring product development • Leasing product development • Exploration into municipal financing • Support for the Ineco Bank DCA transaction • Assistance to banks in connection with bond offerings, workshop on alternative financing • Municipal finance exploration • Assistance to MCC rep on bank operations 	<p><u>Baseline Assessment</u></p> <ul style="list-style-type: none"> • Basel compliance assessment completed <p><u>Unified Regulation</u></p> <ul style="list-style-type: none"> • Follow- up advice on reorganization <p><u>Risk-Based and Consolidated Supervision</u></p> <ul style="list-style-type: none"> • Discussion on RBS • Proposal for presentation to CBA <p><u>Framework for Fighting Money Laundering</u></p> <ul style="list-style-type: none"> • Discussion and proposal to UBA <p><u>Other</u></p> <ul style="list-style-type: none"> • Review of tax situation regarding intermediation and investment • Extension of comparative research on enforcement practices 	<p><u>Legal Reform</u></p> <ul style="list-style-type: none"> • Review of truth in savings law • Review of consumer credit law • Review of proposal for financial ombudsman <p><u>Information Sharing</u></p> <ul style="list-style-type: none"> • Work with banks to define workable format for credit reporting for mortgages • Support and sponsorship for translation of accounting and auditing standards <p><u>Corporate Governance</u></p> <ul style="list-style-type: none"> • Preparation of the corporate governance study • Commencement of work on corporate governance manual <p><u>Professional Education, Training, and Capacity</u></p> <ul style="list-style-type: none"> • General public survey prepared to commence • Study of remittances under preparation • Training needs assessment prepared to commence
INSURANCE	<p><u>Assistance to Insurance Companies</u></p> <ul style="list-style-type: none"> • Presentation for insurers and brokers to solicit technical assistance interest • Information gathering on sector 	<p><u>Baseline Assessment</u></p> <ul style="list-style-type: none"> • IAS compliance assessment scheduled <p><u>Unified Regulation</u></p> <ul style="list-style-type: none"> • Follow- up advice on reorganization 	<p><u>Legal Reform</u></p> <ul style="list-style-type: none"> • Review of insurance law and regulations <p><u>Professional Education, Training, and Capacity</u></p> <ul style="list-style-type: none"> • General public survey prepared to commence • Training needs assessment prepared to commence



	<ul style="list-style-type: none"> Relationship building with insurance association <p><u>Product Development</u></p> <ul style="list-style-type: none"> Initial design of title insurance product <p><u>Capacity-Building</u></p> <ul style="list-style-type: none"> Actuarial certification work commenced Support to CBA for development of statistics center 	<p><u>Risk-Based and Consolidated Supervision</u></p> <ul style="list-style-type: none"> Work commenced with CBA insurance division Discussion on RBS Proposal for presentation to CBA <p><u>Other</u></p> <ul style="list-style-type: none"> Extension of comparative research on enforcement practices 	
PENSION	<ul style="list-style-type: none"> Working group activities Review of working papers Workshop attendance and participation Meeting with World Bank mission Training at the FIAP conference, Bulgaria Agreement to conduct econometric analysis on Pillar II system 	<ul style="list-style-type: none"> Paper on approaches to pension fund regulation Discussions with World Bank and CBA on structure and institutional positioning of pension regulation 	<p><u>Legal Reform</u></p> <ul style="list-style-type: none"> Review of pension law Review of securities related legislation affecting investment management
SECURITIES	<ul style="list-style-type: none"> Support for bank bond offerings OMX and ArmEx merger discussion support 	<p><u>Baseline Assessment</u></p> <ul style="list-style-type: none"> IOSCO compliance assessment completed <p><u>Unified Regulation</u></p> <ul style="list-style-type: none"> Follow-up advice on reorganization <p><u>Risk-Based and Consolidated Supervision</u></p> <ul style="list-style-type: none"> Discussion on RBS Proposal for presentation to CBA <p><u>Other</u></p> <ul style="list-style-type: none"> Sponsorship of training at US SEC for CBA staff Review of tax situation regarding intermediation and investment Extension of comparative research on enforcement practices 	<p><u>Legal Reform</u></p> <ul style="list-style-type: none"> Multiple-rounds of reviews of new securities law Review of draft law on capital requirements Review of the IOSCO assessment <p><u>Information Sharing</u></p> <ul style="list-style-type: none"> Support and sponsorship for translation of accounting and auditing standards <p><u>Professional Education, Training, and Capacity</u></p> <ul style="list-style-type: none"> General public survey prepared to commence Training needs assessment prepared to commence
MORTGAGE	<ul style="list-style-type: none"> Role clarification with KfW – FSDP will take secondary market emphasis Input to IFC on mortgage market Relationship development with mortgage association 		<p><u>Legal Reform</u></p> <ul style="list-style-type: none"> Multiple rounds of review of the draft law on securitization Review of draft law on mortgage bonds <p><u>Information Sharing</u></p> <ul style="list-style-type: none"> Legislative review of credit reporting law Support to ACR and CBA on unifying reporting formats



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			<p>and creating joint efforts</p> <ul style="list-style-type: none">• Work with banks to define workable format for credit reporting for mortgages <p><u>Professional Education, Training, and Capacity</u></p> <ul style="list-style-type: none">• General public survey prepared to commence• Training needs assessment prepared to commence
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