

CENTRAL BANK OF THE REPUBLIC OF ARMENIA

THE BANKING SYSTEM OF ARMENIA

Development,
Regulation,
Supervision

YEREVAN
2004

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INTRODUCTION

Armenian Banking System - Development, Regulation and Supervision describes the development trends and reforms in the Armenian banking system throughout 2003. The Central Bank of the Republic of Armenia (the Central Bank) published similar papers in 1999 and 2000, which described institutionalization and development of the banking system, and the macroeconomic environment since 1994.

External financial inflows and domestic economic activity determined higher than programmed economic growth, which has been incidental to the countries' success in achieving a completed transition period. The economic growth was 13.9% compared with the program 6%. The inflation later in the year was 2.9%, without considering changes in bread and cereals prices, while the actual indicator of inflation was 8.6%, when considering changes in wheat prices. In fact, the aggregate supply has echoed the growth of the aggregate demand, otherwise the year 2003 would have seen much lower economic growth and higher prices. The growth of assets of the banking system during the year was 16.0%.

The highest real growth, 44.4%, was in the Construction area. Even though Construction was carried out mostly on account of external funds, the banking system's loans to the area grew by 46.7%.

A large growth, 52.5%, was recorded in the Consumer Loans area, most likely owing to increased household income. Over 2003, the household income grew in real terms by 9.9%, while the expenditures grew by 12.2%. The purchase of goods and services represented 76.0% of income. Access to Consumer Loans on the one hand, and growing income on the other, have been a major drive to obtaining consumer goods.

Because of adverse weather, the real Agricultural Output in 2003 was 4.3%. The loans to the Agriculture area reduced by 1%. The avoidance of further loan losses seemed to be the motivation for decreased lending.

With the rapid growth in GDP, the share of private consumption in GDP decreased in 2003 to 84.5% from 89.6% the previous year. Under

growing aggregate demand, the shrinking share of consumption implies growth in savings. The growth of time deposits by 10.3% and demand deposits by 63.0% are evidences of this trend.

For development of the country's financial system, the strategy of the Central Bank was focused on having a structured, institutionalized banking system, by creating a banking system that would be well prepared to function as financial intermediaries. In this context, achievements in the system for 2003 were weighty enough. Particularly, credit institutions began operating, the Credit Registry launched its activity so as to minimize the credit risk, and the Deposit Guarantee Scheme was created in order to defend the depositor's interest. The number of plastic cards doubled to broaden the spectrum of banking services thus enabling the origination of demand and cheap resources at banks.

In spite of the system's lower financial intermediation, the trends in growing volumes of the banking system, risk management and rising profitability were positive. The current level of development of the Armenian banking system may be considered as satisfactory if compared with that of the former USSR countries, with the exception of the Baltic countries. The indicators describing financial intermediation underscore this fact. Thus, the country's total bank assets to GDP ratio is 17.4%. In 2002, the average ratio in 7 CIS countries¹ (CIS-7) was 18.3%; in the Baltic and Central European countries (BCE countries) - 74.4%. The ratio of deposits attracted from the economy (save for other financial organizations) to GDP is 11.3%. This indicator exceeds the CIS-7's 10.7% but stands well below the BCE countries' 47.9% (for 2002).

Two important factors determine the low level of financial intermediation: i) weak depositor confidence in the banking system, and ii) large credit risk. In practice, these factors find reflection

¹ The data on CIS-7 and BCE countries used in this paper are taken from *Financial Development in the CIS-7 Countries: Bridging the Great Divide*, published by the IMF, October, 2003. The publication contains the data on CIS-7 countries: Armenia, Azerbaijan, Georgia, Kyrgyz Republic, Moldova, Tajikistan and Uzbekistan.

in the relatively high interest rate spread. In particular, Armenia's bank interest rate spread is two times wider than the 5.3 percentage point interest rate spread in the BCE countries.

Weak mechanisms to defend creditor and borrower rights, deficient legal framework, inadequate audit and bookkeeping standards in the real sector all cause credit risk to increase irrespective of the macroeconomic developments. Under such conditions, banks restrain the growth rates of lending. Thus, Armenia's loan investments to GDP ratio is 8.0% whereas it is 9.7% in the CIS-7 and 31.4% in the BCE countries. Notwithstanding these developments, banks have been seeing their net foreign assets climb significantly in the recent two years, owing to the assets allocated in overseas banks. Armenian banks find it meaningful to keep the attracted resources in low-yield but reliable assets.

ARMENIAN BANKING SYSTEM IN 2003

Banks operating in Armenia

As of the end of 2003, the Armenian banking system comprises 20 banks (with 232 branches), of which 19 banks operate under general supervision, and 1 bank operates under special supervision. The latter operates under the temporary administration assigned by the Board of the Central Bank.

All head-offices and one third of the branches, which makes the dominant part of banks and other financial organizations, are concentrated in Yerevan. In the regions of Armenia, operators are the branches only, which carry out limited banking business.

In 2003:

- A liquidation procedure started at *United Bank, Ardshinbank, Credit Yerevan Bank, and Credit Service Bank*;
- *Armagrobank* decided on self-liquidation;
- *Gladzorbank* restructured into a credit institution; and
- *ArdshinInvestbank* was granted a banking license.

For the first time in Armenia a purchase & sale of the assets and liabilities of a bank took place. *ArdshinInvestbank* acquired part of *Ardshinbank's* assets and liabilities in the first quarter of 2003, and part of *Armagrobank's* assets and liabilities in the fourth.

By ownership, banks are broken down as follows: 1 bank is a cooperative bank, 2 banks are limited liability companies, 2 banks are open joint stock companies and 15 banks are closed joint stock companies.

Bank ownership

Armenia's banking system participants (shareholders, equity holders) involve 1644 physical and legal entities, of which 62 are non-residents. Without consideration of the 2 banks as open joint stock companies, participants of the 18 banks number 89 physical and legal entities, of which 30 are non-residents. 4 legal entities, 2 of which are non-residents, hold a 100% equity. In 10 banks, one shareholder holds more than 50% of shares.

Bank customers

The number of legal and physical entities serviced by the banking system increased by 20.1% due largely to growing number of physical entities. At the end of the year, the number of physical and legal entity customers reached 405.6 thousand, of which 92% (372.4 thousand) are physical entities.

The number of bank accounts increased by 13.6% to 406.8 thousand, of which 94% are current accounts and 6% are time accounts. The number of current accounts increased by 17.2% or 55.9 thousand, owing to physical entity accounts. The number of time accounts decreased by 22.1% or 7.3 thousand to 25.8 thousand. As such, the decrease referred to time accounts of both physical entities and legal entities.

Payment and settlement system

The number of cards issued by the banking system increased in 2003 by 173% to 61.1 thousand. 43% of cards represent ArCa cards, which more than doubled in 2003. As of December 31 2003, approximately 26 thousand ArCa cards, 23.5 thousand VISA cards, 1.3 thousand MasterCard cards, and 10.4 thousand other international cards were in circulation. At end-year, the number of members of the ArCa Unified Payment System was 13, however ArCa cards were issued and serviced by 11 member banks. 5 banks are members of the MasterCard international payment system, another 5 banks are members of the VISA international

payment system. In 2003, the value of transactions carried out in Armenia via plastic cards was Dram 59.5 billion outstripping the previous year's indicator by 67%. The number of transactions was close to one million outstripping the previous year's indicator by 63%.

Armenian banks are members of the systems WESTERN UNION, MONEY GRAM, ANELIK, UNISTREAM, EXPRESS, etc. In 2003, the inflow of funds to Armenia via these systems totaled Dram 175.0 billion, the outflow totaled Dram 18.3 billion. The inflow outstripped the previous year's indicator by 32%, and the outflow outstripped the previous year's indicator by 20%. The ANELIK system accounts for 40% of the inflow of funds. With its share of 25.4%, the UNISTREAM stands below ANELIK. The number of transfers via these systems in 2003 outstripped the previous year's indicator by 35.8% - 738.6 thousand transactions were carried out, of which 706.7 thousand are the transfers to Armenia and 31.9 thousand are the transfers from Armenia.

As of December 31 2003, the number of banks as members of the S.W.I.F.T. System was 17. The value of transfers abroad via the system outstripped the previous year's indicator by 34% while transfers from abroad, by 32%.

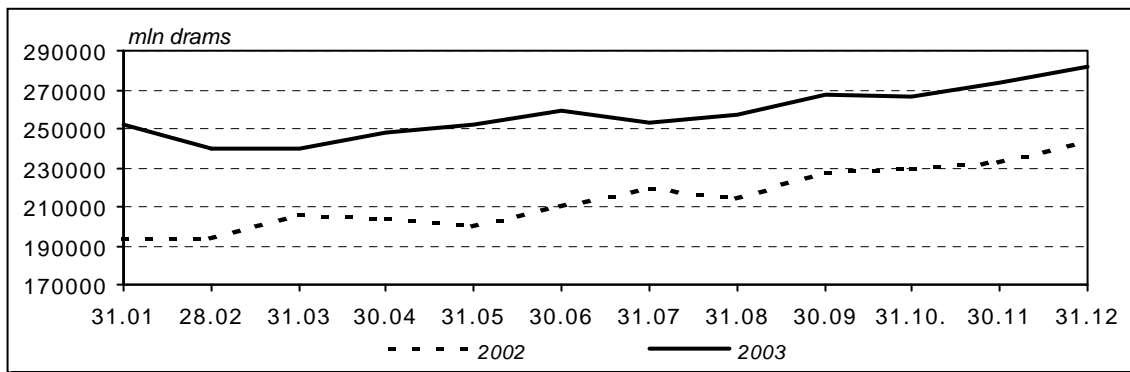
Banking System Assets ²

Total assets³ of the Armenian banking system grew during the year by 16.0% (Dram 39.0 billion) to amount to Dram 282.1 billion or 17.3% of the nominal GDP, as of December 31 2003.

² *The analysis in this section contains the reports which banks provided to the Central Bank according to Regulation 3 Bank Statements, Reporting and Release.*

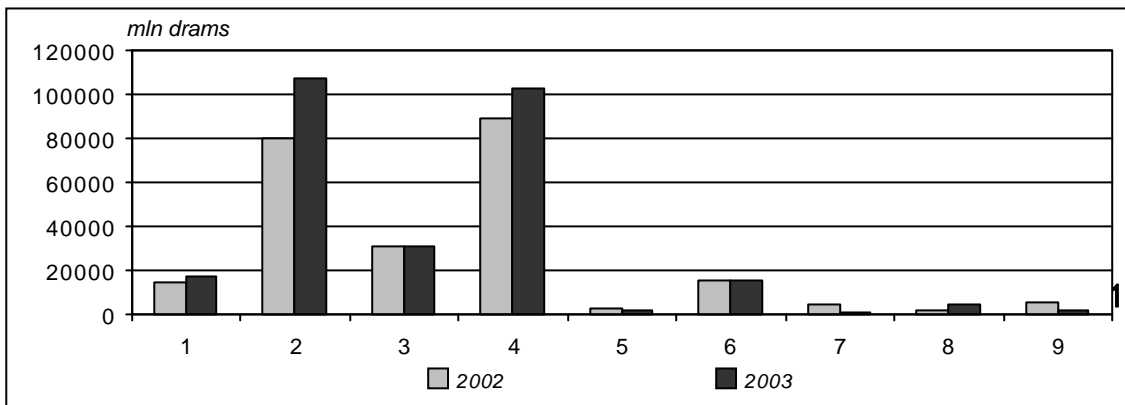
³ *In order to get a more realistic picture, the review of the development trends of the banking system has used a/ financial and economic performance indicators of 19 banks operating under the general supervision, as of 31/12/03 (since the activities of the bank operating under the special supervision are limited by the temporary administration) and b/ overall indicators of 20 banks operating under the general supervision and indicators of Ardshinbank operating under the special supervision, as of 31/12/02. The indicators of Ardshinbank were included because of ArdshinInvestbank having purchased a considerable portion of Ardshinbank's assets and liabilities.*

Figure 1. Total assets developments



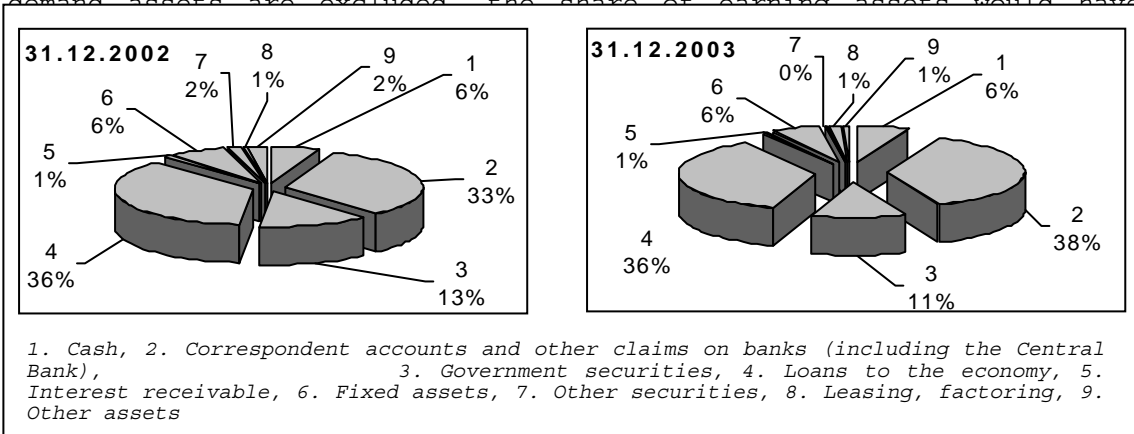
The growth of total assets was due largely to bank correspondent accounts increased by Dram 21.5 billion and loans to the economy increased by Dram 13.5 billion. The growth of correspondent accounts is attributable to the consideration to retain current liquidity at banks, since the liabilities have grown at the expense of demand liabilities. Nostro correspondent accounts show high concentration in terms of residency and geographical coverage. Thus, 97.3% of correspondent accounts are with non-resident banks; 71.3% of such accounts are placed with prime-rated US banks, 10.0% are placed with Russian banks, and 18.7% are placed with European banks and banks in other countries.

Figures 2 and 3. Assets growth trends and assets share, 2002 and



2003

The share of earning assets in total assets was 80.1%. If low-yield demand assets are excluded, the share of earning assets would have



The lending to residents during the year has exceeded by almost ten times the lending to non-residents, i.e. the growth of loans to non-residents was 2.0% or Dram 0.5 billion, while the growth of loans to residents was 21.5% or Dram 18.0 billion.

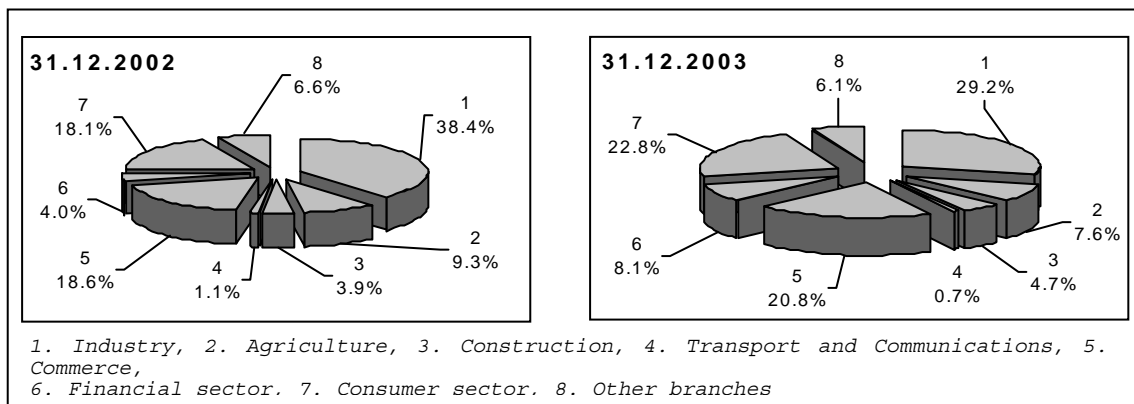
Economy lending trends

The year 2003 saw an unprecedented growth of consumer loans by 52.5% or Dram 8.0 billion. Considerable were the growths of loans to the following branches: Trade (35.6% or Dram 5.6 billion); Financial sector (147.6% or Dram 4.9 billion); and Construction (46.7% or Dram 1.5 billion). Having made loan investments of Dram 4.8 billion into Construction, the banking system has provided the Construction industry with sufficient amount of guaranty at about Dram 3.5 billion. A 7.5% or Dram 2.4 billion decrease was reported in the volume of loans to the Industry as a result of reduced lending in the branches of Energy, Chemistry and Metallurgy.

The Herfindahl-Hirschman Concentration Index⁴ is very low for the system - 0.14. The same indicator across banks has averaged 0.28, which is evidence that some banks still have a relatively high degree of concentration in sectoral lending. It should be noted that this indicator dropped in 2003 by 0.08 points against the level reported in 2002. Notable decline of the Index against the level reported earlier that year was felt at almost all banks.

Figure 4. Loans to residents and structure of receivables, by branches of the economy

⁴ The Herfindahl-Hirschman Concentration Index accepts values between the range from 0 to 1 and denotes the degree of concentration (values close to 0 denote a low degree of concentration).



Quality of loan portfolio

The quality of loan portfolio improved significantly. In loan investments, prolonged and overdue loans decreased by 36.3% (Dram 3.5 billion) to Dram 6.2 billion. Prolonged loans decreased by 17.6% (Dram 1.1 billion), and overdue loans, by 63.7% (Dram 2.5 billion). The share of prolonged and overdue loans in total loans was 4.8%.

As of December 31 2003, non-performing assets (loans and receivables) amounted to Dram 6.3 billion or 5.0% of total loans. 23.6% of non-performing loans is relevant to non-residents, while 76.4% is relevant to residents. The main portion of non-performing assets in total loans to residents involves the Consumption (30% or Dram 1.4 billion), the Industry (24% or Dram 1.1 billion), and the Trade (19% or Dram 935 million).

International credit projects

More resources for disbursement from the international financial institutions is an important stimulus for creating long-term funds in Armenia and developing the national economy that needs such resources.

Nine banks service credit projects which are implemented by the international institutions such as: the Lincy Foundation, the German-Armenian Fund, the World Bank, Eurasia Foundation, the US Department of Agriculture, European Bank for Reconstruction and Development, the International Fund for Agricultural Development, and the Shore Overseas Corporation Holding. These projects cover almost all spheres of the economy. During 2003, the share of long-term (with maturity of one year and more) loan investments increased by 5.4 percentage points to make up 38.0% of total loan investments.

The German-Armenian Fund accounts for 66% of the loans provided under the international projects. Loans provided to the sectors of the economy were broken down as follows: Trade - 38.2%; Agriculture - 26.0%; and Food Production - 16.8%.

The volume of loans provided by banks under the international projects grew in 2003 by 21% to a total of Dram 21.2 billion, or 16.4% of total loans, at the end of the year. The rate of collection of these loans is high as overdue loans constitute a mere 0.3%. The loans with maturity of over one year, provided under the international projects, equal 84.0%; loans with maturity from six months to one year equal 15.6%; and loans with maturity up to six months equal 0.4%.

Overall, from the start of the international loan projects until December 31 2003, the banks involved in these projects have provided close to Dram 49.5 billion-worth of loans, with a collection rate of 98.8%.

Investments in securities

The volume of investments in Armenian government securities remained almost unchanged. They grew a mere 0.3% to Dram 31.3 billion late in the year (including the securities purchased and sold through repo agreements). These trends are determined by a declining yield on Armenian T-bills and an unprecedented growth of the assets of other categories.

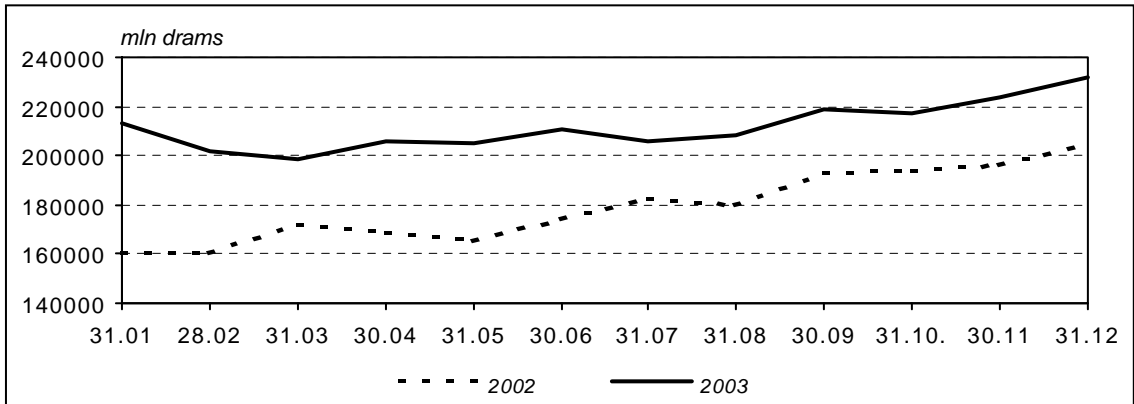
The volume of investments in other securities, considered as high risk-rated, decreased in 2003 by 89.4% to Dram 461 million by yearend.

Banking System Liabilities

Total liabilities of the Armenian banking system grew during 2003 by 13.4% to Dram 232.0 billion by yearend. The liabilities in both dram and foreign currency grew by 13.4%, which made their share unchanged as a component of total liabilities. Continued high dollarization is apparent as the share of liabilities in dram considerably yields to the share of FX liabilities, and constitutes a mere 27%.

Although some banks have been liquidated in the recent years, these events have not adversely affected the confidence in the banking system. As such, the main contributors to the growth of total liabilities were aggregate demand and time deposits of individuals (with 34.6% growth) and deposits of legal entities (with 9.6% growth).

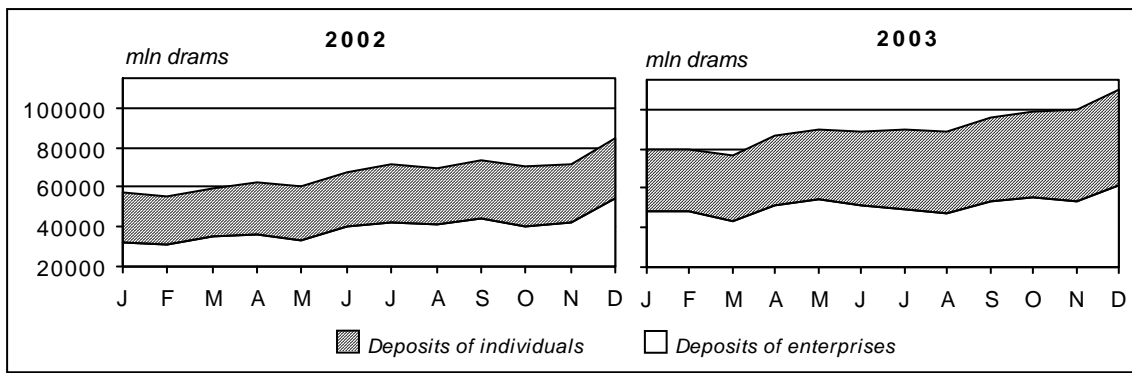
Figure 5. Growth trends of total liabilities



Total deposits of the banking system (including bank accounts) grew during the year by 21.4% to amount to Dram 188.0 billion later the year, of which 75.1% represent the deposits of residents and 24.9% represent the deposits of non-residents. The year 2003 saw a huge growth in demand deposits by 30.7% or Dram 25.9 billion, in which the share of demand deposits of physical entities prevails. The growth of demand deposits was largely attributable to the revival of sole entrepreneurship. The number of card accounts rose as more and various organizations began practicing a card system-based payment of salary. Thus, the share of demand liabilities in total liabilities increased by 6.2 percentage points.

The growth of time deposits was behind the growth of demand deposits, making up 10.3% or Dram 7.2 billion, of which Dram 6.5 billion growth was due to time deposits of individuals. As of December 31 2003, the time deposits were Dram 77.6 billion or 33.4% of total liabilities.

Figure 6. Growth trends of demand deposits



As of December 31 2003, the share of interest bearing liabilities in total liabilities of the banking system was 91.7%. If low-cost demand

liabilities are excluded, the share of interest bearing time liabilities would have been 43.9%.

Figure 7. Growth trends of time deposits

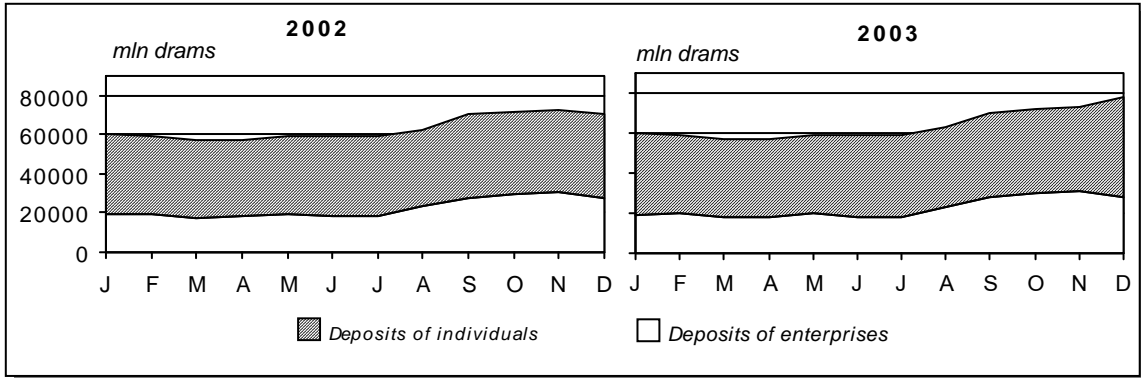
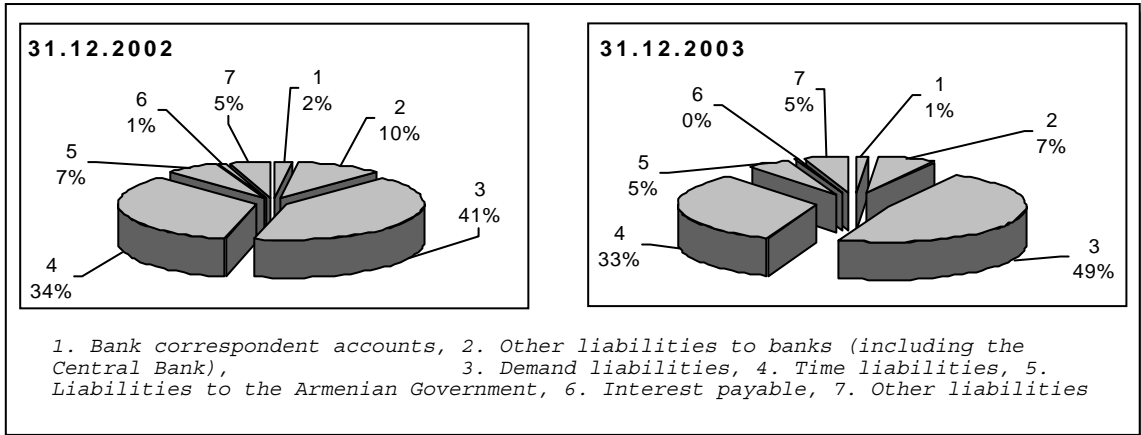


Figure 8. Liabilities structure



Capital Adequacy of the Banking System

The book value of the Armenian banking system increased over 2003 by 30.0% or Dram 11.6 billion to total Dram 50.1 billion. The growth of the total capital is attributable to the growth in statutory capital by Dram 2.0 billion and to the year's retained profit of Dram 6.5 billion. The liquidation of Ardshinbank, which had Dram 5.6 billion accumulated loss as of December 31 2002, was significant. The amount of the loss is not included in the total capital reported for year ended December 31 2003. During the year, 5 banks paid Dram 1.5 billion of dividends, 87% of which were paid by one bank.

The statutory capital grew considerably as the minimum total capital has been set since July 1 2003 to be USD 2 million equivalent in Armenian drams.

As of December 31 2003, the statutory capital of the banking system was Dram 36.8 billion. The non-resident participation in the equity declined by about 5 percentage points to constitute 46.7%.

As of December 31 2003, the leverage ratio (the ratio of total capital to total assets) was 17.8%. This ratio is high mainly in small banks, which are unable to compete with major banks for expansion of assets and liabilities.

Armenian banks are well capitalized. Higher than required indicators of capital adequacy ratios can be evidence of this. As of December 31 2003, the total capital adequacy ratio was 34.1% and the core capital adequacy ratio was 32.6%, whereas the required level for these two indicators is 12% and 8%, respectively. In view of measuring the exposure to capital, where all non-performing assets of the banking system are categorized as bad, the subsequent loss would constitute 7.6% of total capital.

Banking System Profitability ⁵

⁵ The profitability indicators of 2002 do not include Ardshinbank's data.

In 2003, the banking system generated high profits, and the system's undistributed profit amounted to Dram 6.5 billion⁶. The profitability by assets (undistributed profit divided by average annual amount of assets) was 2.7%, and by capital (undistributed profit divided by average annual amount of capital) was 14.4%. These indicators in 2002 were 2.4% and 13.3%, respectively. Net operational margin⁷ of the banking system was 4.1%.

During the year, 16 banks reported profit, 3 banks reported losses. The undistributed profit of the 16 banks was Dram 6.9 billion, the total losses of the 3 banks were Dram 408 million.

The Herfindahl-Hirschman Concentration Index at profit generating banks is low - 0.13.

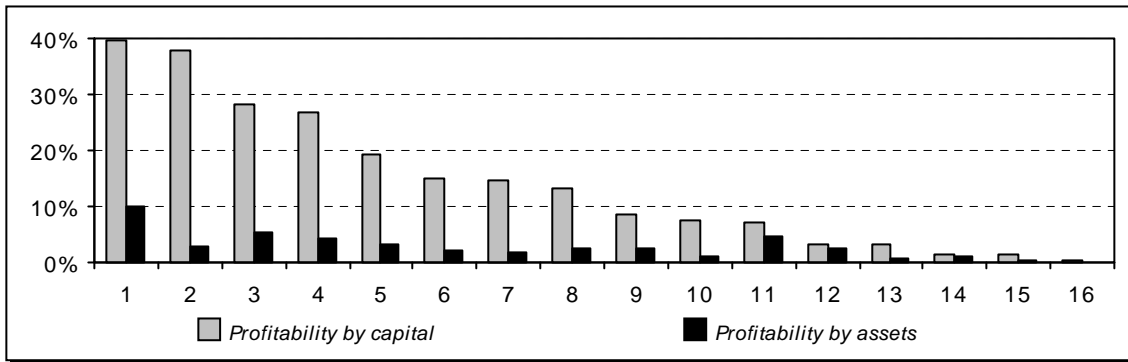
In 2003, gross income increased by 19.7%, and gross expenditures, by 15.4%. Interest income and non-interest income, and collection from the assets loss reserve fund (ALRF) grew almost proportionally, by 19.8%, as opposed to the previous year.

On the expenditures side, the growth was not proportional: the expenditures grew by 16.0% and the assets loss provisioning, by 25.5%. However, interest expense decreased by 2.9%, which was the result of declining interest rates. It is worthwhile mentioning that the decline in deposit interest rates was greater than the decline in loan interest rates.

Figure 9. Profitability by 16 profit-generating banks

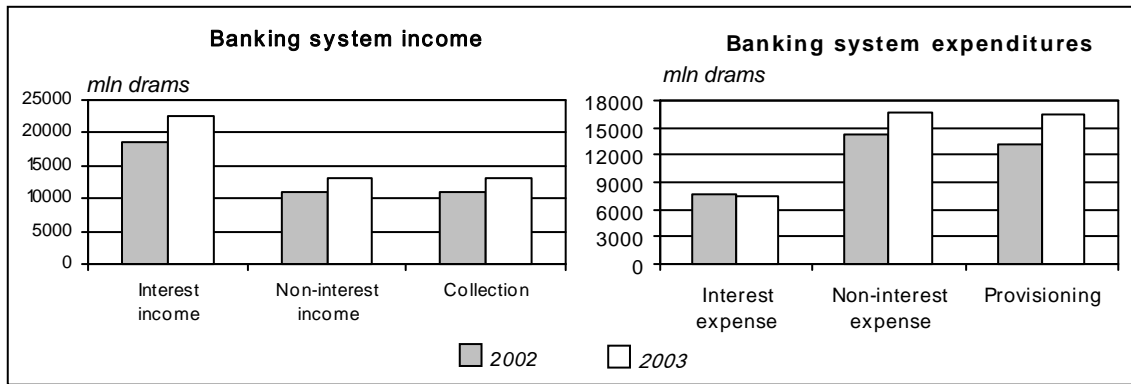
⁶ Where Dram 546 million of profit, earned by the bank operating under the special supervision in 2003, is considered, the overall 2003 bank profits would have been Dram 7.1 billion.

⁷ Net operational margin is the amount of net interest and net non-interest incomes divided by the amount of total assets.



The growth of the undistributed profit in 2003 was attributable to net interest income, which exceeded the previous years' indicator by 35.2% (Dram 3.9 billion).

Figure 10. Banking system income and expenditures

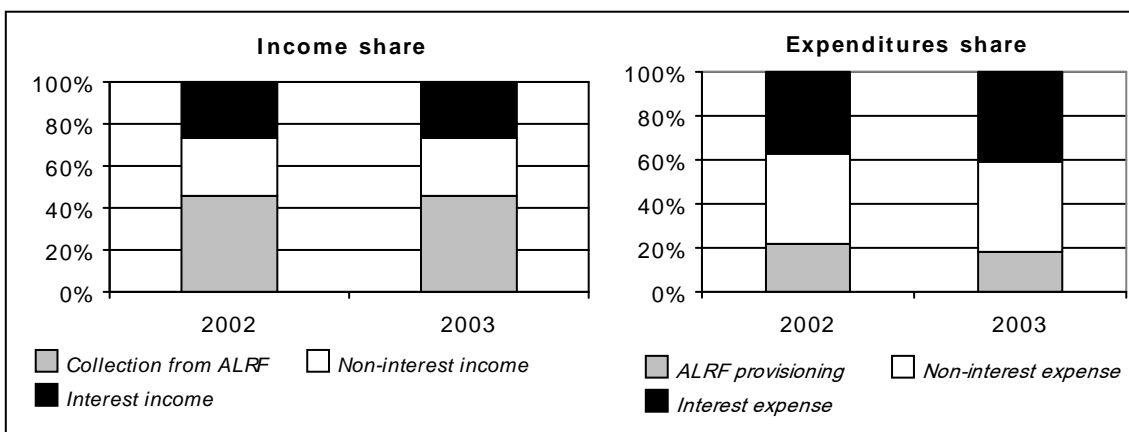


Interest income on loans to the economy grew by 25.0% (Dram 3.2 billion) to make up 71.2% of interest income, as opposed to 68.2% in

2002. Interest expense payable on time deposits decreased by 7.2% (Dram 352 million) to make up 61.2%, as opposed to 64.1% in 2002.

Commission fee received by the banking system grew by 19.7% (Dram 1.4 billion) making up 65.1% in non-interest income. Salary and salary-equivalents grew by 1.5% (Dram 834 million) contributing to non-interest expense by 35.5%. The bank employee training costs grew by 22.1% (Dram 53.3 million).

Figure 11. Banking system income and expenditures structure



Financial Risks of the Banking System

The review of the financial risks of Armenian banking system (liquidity, foreign currency, interest rate, credit risks) shows that the credit risk, which derives a privileged importance in the current banking system, remains one of the key challenges to the system.

Previous trends of credit risk continued downward during the year. The share of the assets categorized across total loans and receivables decreased by 2.1% to make up 3.3% and 12.8% against total capital. The

indicator of the risk on a single borrower has an acceptable level of 12.5%, as of December 31 2003, which is well under the required maximum 20%. The indicator of the risk on a bank related party was 2.4%, with the required maximum indicator of 5%.

In 2003, the total loss to banks due to the fluctuations of the dram exchange rate vis-à-vis other currencies was Dram 513 million making up 1.1% of the capital of the banking system. The calculation through the VAR (value at risk) model for the measurement of the foreign currency risk shows that the loss on foreign currency revaluation will, with 95% probability, not outpace the Dram 156 million ceiling. This judgment may be exposed to some deviations as the calculations used the open FX positions data provided by banks as of December 31 2003, and such positions might be subject to changes.

To have a realistic picture of the foreign currency risk, banks have since September 2003 been setting the foreign currency disposition standard against both derivative-adjusted positions and balance sheet positions (without derivatives). As of December 31 2003, the first group open position of the banking system was 4.5% of the capital; the second group open position was 1.3%; and the gross FX position was 5.8%. As such, the maximum required gross FX position is 25% and the maximum required second group open position is 5%.

The banking system's liquidity risk is low since the system is comprised of a considerable portion of high liquidity assets (Dram 126.5 billion). This amount is fully adequate in order for the banking system to be free of a liquidity problem. In 2003, the total liquidity indicator rose by 5.0 percentage points to 48.1% at the end of the year. With the demand liabilities growing, the current liquidity indicator dropped during the year by 4.8 percentage points to 101.4% at the end of the year. However, the total and current liquidity indicators are higher than the required norm and do not portend the emergence of a liquidity problem.

The review of the interest rate risk shows that banks do not have major exposure to such a risk. Asset and liability maturities are not long-term at banks. This allows to often revise the interest rates by

monitoring the market changes of interest rates. Net interest income of the banking system in 2003 exceeded the previous year's indicator by 35.2% mostly owing to rising low-cost demand liabilities and highly remunerative consumer and trade loans. The judgment made through the Duration model for measuring the interest rate risk shows that the average weighted maturity gap of the banking system represents a positive value (reaching about a year). This is evidence that the market interest rate fluctuations will not exert a material pressure on economic value of the capital of the banking system. Calculations made through the model denote that in the event of a 2% fall in the general market interest rates (on both assets and liabilities), the economic value of the banking system capital will increase by Dram 380 million.

Credit Institutions in Armenia

The licensing of credit institutions in Armenia started after Armenian Law on the Credit Institutions took effect on January 1 2003.

As of December 31 2003, 6 credit institutions were in operation, 2 of which were as leasing firms. Total assets of credit institutions were Dram 3.5 billion or 1.3% of the assets of the banking system. Total capital of credit institutions was Dram 2.2 billion; liabilities, Dram 1.3 billion; total loan investments, Dram 1.5 billion, and total value of leasing and factoring operations was Dram 945 million. The branches of Industry received 32.7% of the loans and leasing operations provided by credit institutions; Consumer sphere received 20.2%; Agriculture - 12.0%, Trade - 11.4%; and other branches - 23.8%.

According to the 2003 results, 4 credit institutions were profitable, with the total profit of Dram 223 million. Two credit institutions operated with a loss which amounted to Dram 391 million.

BANKING SYSTEM: SUPERVISION AND REGULATION

The Central Bank holds the authority for licensing, regulation, supervision and termination of the activities of banks and other organizations, licensed by the Central Bank, pursuant to Armenian Law on the Central Bank (ALCB) and Armenian Law on Banks and Banking (ALBB). Based on the above laws and other laws and regulations governing the banking system, the Central Bank is the exclusive entity to regulate and supervise the activities of banks. The supervision and regulation of the activities of banking institutions (and other organizations licensed by the Central Bank) is an ongoing process starting from licensing up to terminating the activities of a banking institution.

Functions of units implementing and supporting the implementation of the bank supervision

Within its authority, the Central Bank creates conditions necessary for a stable, liquid, solvent and normal-functioning banking system; and it defends the interests of lenders and depositors. The Bank Supervision Department (BSD), the Bank Methodology and Analyses Department (BMAD), and the Law Department (LD) of the Central Bank are responsible for, and support the implementation of, the supervision of banks in realization of the above objectives.

The main objectives of LD include:

- ✓ Drafting and developing banking legislation and regulations; and
- ✓ Defending interest of the Central Bank in debating issues within the relations between the Central Bank and banks and other organizations licensed by the Central Bank;

The main objectives of BMAD include:

- ✓ Enhancing and improving methodological tools of banking supervision and regulation in line with the development of the

banking system as a whole and the developments of financial institutions in particular;

- ✓ Developing recommendations for laws and regulations, based on the best international practice and consistent with the developments of the banking system;
- ✓ Disclosing problems emerging in the bank supervision and regulation area, and preparing solutions to such problems;
- ✓ Designing prospective development programs for banks; identifying ways to introduce and develop new institutional elements based on the selected solution to the existing problems and surveyed international experience; and working on the technique required for introducing these elements; and
- ✓ Analyzing the directions for general development of the banking system; identifying and reviewing the areas of risk.

The two departments do support the process of bank supervision in the methodical, analytical and legal aspects.

BSD is responsible for the supervisory processes by:

- ✓ Licensing banks and other financial institutions;
- ✓ Supervising the activities of banks and other financial institutions; and
- ✓ Terminating the activities of banks and other financial institutions.

These three departments cooperate closely as they communicate and discuss problems and issues of concern, and determine the introduction of new supervisory methods and tools.

Licensing of banks and other institutions

The Central Bank licenses banks and other institutions subject to the Central Bank licensing pursuant to Regulation 1 Registration and Licensing of Banks and Branches of Foreign Banks (Regulation 1). This

component of licensing is the responsibility of the Licensing and Bank Registry Unit of BSD.

The Board of the Central Bank will approve letters of attorney from banks, whose:

- ✓ Founders are not of poor character and/or criminally prosecutable;
- ✓ Investments in the capital are of lawful origin;
- ✓ Economic program is realistic and meets the Central Bank's criteria;
- ✓ Internal organization is adequate for a normal relationship between the departments and effective risk management;
- ✓ Executive body and management are professional, and meet the Central Bank's criteria; and
- ✓ Documents of incorporation are accurate and free of misstatement.

The Supervision and Licensing Committee of the Central Bank is responsible for reviewing the professional integrity of candidacy for manager, currency dealer of a bank, its branch, a foreign bank's branch, and other institutions licensed by the Central Bank. Qualification criteria are updated and modernized each year by BMAD to best meet the international standards.

Supervision of banks and other institutions

Four units of BSD are responsible for the off-site supervision of banks and other institutions licensed by the Central Bank. The three units are responsible for supervision of bank institutions and other institutions licensed by the Central Bank. The one unit is responsible for supervision of newly created credit institutions.

Off-site supervision is carried out by: i) using the information (through reporting and otherwise) received from banks and credit institutions; and ii) analyzing bank performance in order to evaluate financial condition and the level of risks, and monitor compliance with banking laws and relevant regulations. The implementation of off-site supervision involves the supervisory bodies submitting statements to the Statistics Department (SD) of the Central Bank in accordance with the procedure determined by law and Regulation 3 *Bank Statements; Reporting and Release* (Regulation 3), and Regulation 15 *Credit Institution Statements; Reporting and Release* (Regulation 15). After being reviewed, these statements are presented to BSD and BMAD. The prudential standards for banks and credit institutions, their limits and procedure of calculation are set forth in Regulation 2 *Regulation of Banking; Prudential Standards for Banking* (Regulation 2) and Regulation 14 *Regulation of Credit Institutions; and Prudential Standards for Credit Institutions* (Regulation 14).

Off-site supervision's goal is to identify not only movement in a bank's financial indicators, and particularly the deviations from the limits set by the Central Bank regulations, but also to review the reason for such deviations, evaluate changes in indicators and develop a plan of actions to manage the risks measured. Off-site supervision will also evaluate and review a bank's expected financial condition and risks.

The information received from banks and the reasonable supervisory judgment are used to calculate the CAMELS (Capital, Assets,

Management, Earnings, Liquidity, and Sensitivity) indicator. Where an evaluation is 3 points, the Central Bank will deny the letter of petition to create a branch. Where an evaluation is 2 points and less, a bank will be considered as insolvent.

An off-site supervision is made in order to more thoroughly review the disclosed risks and the reason for their identification at banks and other institutions licensed by the Central Bank. On-site inspection is organized when required by the inspections schedule approved by the decree of the Chairman of the Central Bank. Head of BSD will assign a person to be a chief of an examination team. The chief will submit proposals on composition of the team, prepare a plan of examinations and work schedule.

The plan of examinations, other than those implemented, for instance, by a request of law enforcement bodies, is approved by the Supervision and Licensing Committee. The examination team will prepare an examination report at the end of the examination in accordance with the manual *Implementation of Examinations at Banks, 2003*.

In implementing supervision of various aspects of a bank, the supervisors will evaluate the quality of operation of internal control systems, procedures and internal policies, and effectiveness of internal audit.

Bank supervision involves identifying risks on both assets operations and liabilities operations, reviewing accuracy in, and proper execution of, deposit contracts, and the risks on major creditors, bank related parties and organizations, computer and IT systems, post balance sheet contingencies, payment systems, electronic fund transfers, internal and external audit and etc. Special attention is paid to reviewing a bank's management system and identifying risks on that part, and on defining the scope of rights and responsibilities of the board and executive management of a bank.

Activity of a bank is terminated pursuant to the procedures set forth in ALCB, ALBB, Armenian Law on Bankruptcy of Credit Institutions (ALBCI), and Regulation 7 *The Formation of Temporary Administration*

for Insolvent Banks and Credit Institutions (Regulation 7). These legislative papers provide explication of the grounds for bankruptcy, insolvency and/or liquidation of banks and credit institutions. Once recognized as insolvent, a bank will have to pass its management over to bank administration, which is to be appointed by the Bank Administrators Department (BAD) of the Central Bank. Despite this, the supervision of banks remains the responsibility of BSD. The ground for insolvency of a bank involves: i) depletion of 50% and more of core capital of the bank; ii) inability to satisfy depositor claims; iii) violations of the limits of reserve requirement; and iv) a bank's indicators being 2 points below the Central Bank's requirement.

The Supervision and Licensing Committee

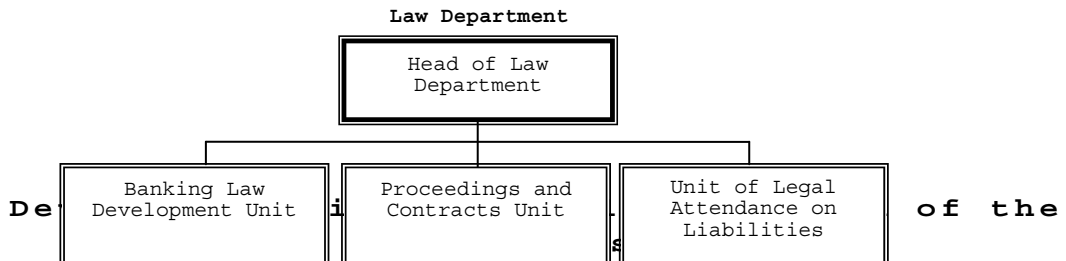
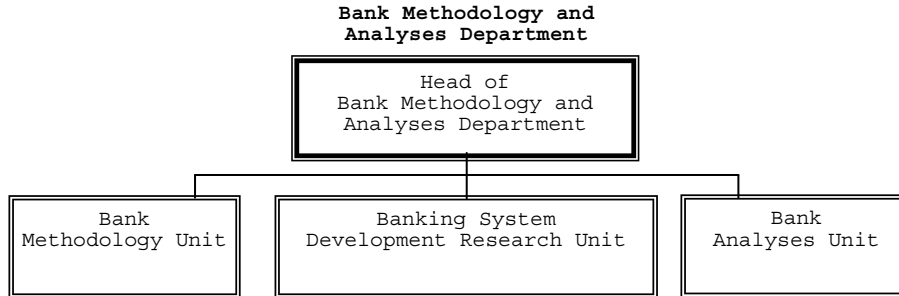
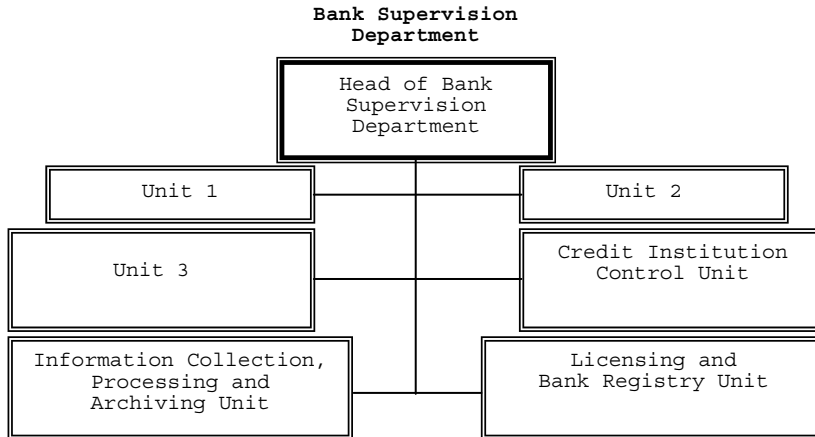
The Supervision and Licensing Committee (the SLC) of the Central Bank, chaired by the Chairman of the Central Bank, is the body that takes the lead in supervising banks. The SLC works through the meetings that are convened when required but not less than once in a week. The SLC members include the heads and employees of the above three units of the supervision service. The SLC addresses issues such as:

- ✓ Preliminary approval to creation of banks; registration and licensing of branches of banks;
- ✓ Qualification and professional integrity of bank managers, currency dealers;
- ✓ Bank violations, application or non-application of sanctions to the bank having committed violation;
- ✓ Licensing and registration of other organizations subject to the Central Bank licensing;
- ✓ Violations committed by other organizations licensed by the Central Bank; explanations and/or objections from these

organizations; and application or non-application of sanctions to them;

- ✓ Registration of changes as provided for by ALBB and Regulation 1; and
- ✓ Other issues ensuing from other authorities provided for by other regulations of the Central Bank.

The Structure of Supervision and Licensing Committee



The year 2003 saw effective changes and improvement in the regulatory field of the banking system. Measures were taken to introduce the best international practice, stabilize the financial system, and raise the effectiveness of banking supervision and provide more comprehensive legislative and sub-legislative framework.

One of the main developments in the field was the introduction of the Credit Registry since January 1 2003. Designed to minimize credit risk, the Credit Registry incorporates an information system that covers useful borrower data and suitably enables the identification of non-diligent borrowers. The Credit Registry is an attempt to create in Armenia an informational database for the credit history of borrowers. To make sure the data in the Credit Registry is accurate, borrowers also may have access to their credit history, and may complain about the misstatement of information.

Since July 1 2003, banks have been making contributions under the *Physical Entity Bank Deposit Guarantee Scheme*, as part of the regulatory developments. The scheme will help resolve an important problem - the depositor interest in Armenia will be defended thus enhancing the household confidence in the banking institutions.

To gain further stability and development and be favorable enough for the attraction of foreign investments, the banking system needs to be more transparent. The work of making the Accounting Standards of the Republic of Armenia (RAAS) to comply to the International Accounting Standards is part of that process.

During the year, the Board of the Central Bank has approved a number of accounting standards, which would enable banks to keep records in accordance with the international standards when implementing banking operations. The approved standards include RAAS 14 *Segment Statements*; RAAS 19 *Employee Remuneration*; RAAS 26 *Record and Reporting of Retirement Benefits*; RAAS 29 *Financial Statements under Hyperinflation*; RAAS 35 *Suspended Transactions*; RAAS 38 *Non-tangible Assets*; RAAS 40 *Investment Property*.

The Chart of Accounts of banks and the Manual for the Chart of Accounts were revised to meet the international accounting standards and to keep current records of new banking operations, with particular emphasis on foreign currency swap operations. Also, the Chart of Accounts for credit institutions and the Manual for the Chart of Accounts became effective starting January, 2003.

Sample forms of *Financial Statements* to be published by both banks and credit institutions and the instruction to fill in these statements were developed and approved to conform bank and credit institution reporting to RAAS and, therefore, to the best international experience. As a result, since the 4-th quarter 2003, banks and credit institutions have been publishing the intermediary and annual financial accounts in accordance with RAAS. It was expected that banks would begin disclosing more information not only through tables, but also through notes to financial statements. This, however, proved unsuccessful, and the efforts did not yield the desired results.

Sub-legislative papers governing the activities of banks were changed to conform to the improved regulatory field, the Basle Principles and the new chart of accounts.

Thus, Regulation 1 provided that the Union of Armenian Banks would be involved in the process of professional integrity examinations for managers serving in the banking sphere. Stressing the importance of increased professional integrity of bank managers, the examination questionnaires were revised and updated appropriately.

Changes were introduced to Regulation 2. Specifically, the foreign currency position will be calculated with and without the inclusion of the derivatives. This kind of arrangement proved very effective as banks markedly reduced the transactions of concluding 'spurious' derivatives. And now it is possible to get an accurate understanding of foreign currency positions of banks and the risks they face. Some other changes were made to clarify and improve the provisions of the Regulation. The changes referred to: i) definition of claims on one

borrower and affiliated parties; ii) components deducted from the total capital in calculating the regulatory capital; iii) calculation of a bank's total and core capital adequacy ratios; and etc. The Regulation allows determining the risk category of bank assets by the rating of international rating agencies (the list of international rating agencies has been approved by the Central Bank).

Changes were made in the forms of statements determined by Regulation 3 to reflect the above changes, and to make the statements, reportable to the Central Bank, more concise and understandable to the Central Bank supervisors and analysts. The forms of consolidated reporting of banks were revised because of the change in the Chart of Accounts.

In 2003, the Central Bank launched an important process - the introduction of internal control system at banks - as a response to remedy weak or, in particular cases, non-existent internal control systems, as had been revealed during prior on-site inspections. The goal of this lies in making sure that the minimum requisites for exercising internal control at banks are in place, there operates an effective and independent internal audit, and to encourage banks to improve their internal control systems in line with a changing environment.

The method by which the strategic planning for banks is prepared improved in 2003. The changes derive from what banks have proposed in preparing such development programs in the past years. As a result of the reforms, the bank indicator forecasting was clarified and the items for forecast generalized.

Bank Supervision in 2003

Consistent measures were taken in 2003 to improve the bank supervision and raise its effectiveness. The banks supervision is targeted to maintain stable, liquid, solvent and normal-functioning

banks and credit institutions. To this end, bank legislators have revised sub-regulatory papers governing banking, as was noted above.

Magnification of banks is one of the strategic issues for the bank supervision - the minimum total capital of banks has been added since July 1 2003 by USD 350 thousand-equivalent drams to USD 2 million-equivalent drams, according to the time-schedule.

In 2003, the Central Bank carried out examinations at Armenian banks and branches of foreign banks in accordance with the manual *Implementation of Examinations at Banks*, in order for supervision to perform also a preventive function in addition to handling the past and current problems of banks.

The Manual is prepared in such a way in order for the supervisors to obtain a clear and accurate understanding of the bank's internal control system, operational procedures and internal policies and principles governing the activities in these areas. The supervisors have a good chance to fully understand and evaluate a bank's internal control system, the effectiveness of the internal audit and to determine whether the bank staff follows the principles set out by management. Such review allows the evaluation of a bank's financial condition, performance of transactions, effectiveness of management and assessment of the internal control system. The efficiently operating internal control system seems to be a platform for the Central Bank in introducing and then applying the principles of corporate governance at banks.

In order to make examinations at banks as effective as possible, the Manual thoroughly describes the process of preparing an examination plan. There may be both complex and target examinations. The Manual is also helpful for a novice supervisor.

In 2003, the Central Bank implemented 17 examinations - 7 complex and 10 target inspections. The grand amount of total assets of banks inspected was Dram 85.8 billion. The problems revealed during examinations refer mostly to weak internal control systems and the lack of corporate governance principles.

Examination effectiveness and supervisory (functional) commitment

Indicator	2002	2003
1. Number of employees of BSD	34	39
2. Total assets of banking system (average annual)	Dram 195.6 billion	Dram 253.6 billion
3. Average supervisory commitment per BSD employee (2:1)	Dram 5.8 billion	Dram 6.5 billion
4. Number of examinations implemented during the year, including:	19	17
Complex inspections	4	7
Target inspections	15	10
5. Total assets of banks after examination	Dram 36.0 billion	Dram 85.8 billion
6. Number of examiners	31	42
7. Average supervisory commitment per supervisor in examination	Dram 1.2 billion	Dram 2.0 billion

6 credit institutions and 1 commercial bank were licensed in 2003.

In the supervision development framework, certain off-site supervisory tools, particularly UBPR (Uniform Bank Performance Report) and CAMELS, improved. The set of supervisory tools was replenished with new risk assessment methods to respond to the developing commercial bank sector, increasing number and broadening spectrum of banking services. On the other part, the latest international experience, which is mostly applicable to Armenia's banking system, is a benchmark for the improvement of supervisory tools.

Brief and thorough analyses are made for the evaluation by the CAMELS system to identify a bank's potential risk aspects and problems. The new CAMELS methodology enables supervisors to apply subjective criteria such as the factors determining the objective evaluation, the recently received information (that is not reflected in objective evaluations but may affect a bank's financial indicators), and etc. Where objective criteria fail to accurately

reflect the problems and potential risks of a bank, the evaluation should determine how would the objective criteria be evaluated if the disclosed problems were to be considered. The evaluation of a bank's indicators is made on a monthly basis, after which the Central Bank declares the individual survey evaluation of the bank.

In response to the existing problems in the Armenian banking system in the recent years, the Central Bank has developed and introduced the guidelines *Qualifying Banks as Problematic Banks and Implementing Supervision over Them*. This paper describes the criteria that classify a bank as a problem bank and defines the list of required action. Aimed at increasing the effectiveness of problem bank activity and ensuring the transparency, Regulation 7 sets forth new requirements for an insolvent bank's reporting under the financial rehabilitation program (particularly, the temporary administration should present the forecasts for the results of its activity, and the actual results afterwards).

The recently developed supervisory techniques include the VAR model for the evaluation of foreign exchange risk. The model calculates the maximum extent of possible loss banks may incur in the future due to a change in the foreign exchange rate.

The *Duration* model allows evaluating the interest rate risk - the maximum extent of loss/gain banks may have due to certain (presumable) changes in interest rates.

A gap model-based technique was developed for the evaluation of a bank's liquidity, which helps describe both the total liquidity and the instant and time liquidity levels of a bank. The advantage is that, in case of consistent monitoring, the denoting of further scenarios for bank liquidity will become possible.

Stress tests were developed to evaluate a bank's maximum loss on credit, foreign exchange and liquidity risks and to disclose the violation of prudential standards set by the Central Bank.

In 2003, the FINA database system for banks' data consolidation and storage underwent essential changes. The system's software was updated, the database was formed and the data processing systems were

put into operation. The full entry and survey procedures of bank reporting through the FINA system may be considered as significant achievement for the year.

Cooperation with foreign supervisors and international organizations

The supervisors of the Central Bank closely cooperate with their counterparts in the Transcaucasia Region and European countries. Through conferences and meetings, the supervisors discuss solutions to bank supervision-related issues and seek ways for improvement of supervisory tools and techniques. The exchange of views and opinion on urgent issues, the presentation of experience and know-how on risk evaluation under the economic uncertainty are very important for the development of the concept of bank supervision. The exchange of information on the regulatory field with foreign countries and international organizations is an ongoing process. In this context, in 2003 the Central Bank signed agreements with the Central Bank of Russia and the Central Bank of Lebanon concerning cooperation in the area of the exchange of information and supervisory experience.

The attention of the world's financial institutions is focused on the Basle New Accord II. The use of the Accord will open new horizons for the improved supervision. Experts of the Central Bank review the possible ways of introducing the Basle Accord II to different jurisdictions. Obviously, Armenia is not yet prepared to completely accept the Basle Accord II criteria, but many core principles are applicable and will promote increased effectiveness in bank supervision. The use of several principles concerning arrangement of inspections and market discipline will positively affect the bank supervision.

Annex

Banks, credit institutions and their branches

31.12.2003

Banks		Branches
1	ArmSavingsBank	101
2	ArdshinInvestBank	61
3	ArmEconomBank	24
4	Artsakh Bank	11
5	Converse Bank	8
6	Agricultural Cooperative Bank	8
7	UniBank	5
8	Anelik Bank	5
9	AreximBank	4
10	Ineco Bank	2
11	HSBC Bank Armenia	1
12	Prometheus Bank	1
13	ArmImpexBank	-
14	Armenian Development Bank	-
15	ArmInvestBank	-
16	Mellat Bank	-
17	Emporiki Bank-Armenia	-
18	International Trade Bank	-
19	InterInvestBank	-
20	Armkap Bank	1
Total		232

Credit institutions		Branches
1	Arfin Credit Union	-
2	Agroleasing lease firm	-
3	AGBA leasing credit institution	-
4	SEF International versatile credit institution	1
5	Express Credit versatile credit institution	-
6	Gladzor versatile credit institution	-
Total		1

Annex 2

Survey balance sheet indicators of the banking system

thousand AMD

		31.12.02	31.03.03	31.06.03	30.09.03	31.12.03	Change 31.12.03- 31.12.02	
Assets								
Cash	D	3606798	3160801	3470369	4352970	4826950	1220152	33.8%
	F	10491205	11230039	12938969	12483882	12551870	2060665	19.6%
Correspondent account and required reserve balances	D	19168368	15099008	14979177	16820990	20734143	1565775	8.2%
	F	41142638	46055059	60114270	55398446	62396975	21254337	51.7%
Government securities		31232848	30667702	34139988	35429600	31311092	78244	0.3%
Liabilities on repo agreements		-4439701	-4491503	-5680464	-4658779	-2491066	1948635	-43.9%
Deposits with the Central Bank	D	0	0	1600000	1121733	100000	100000	-
Deposits with banks	D	68093	1233443	2013130	1475193	652247	584154	857.9%
	F	19691399	19168603	14321092	22221300	22950759	3259360	16.6%
Loans to economy	D	19057449	22580556	25657147	29788920	32482437	13424988	70.4%
	F	65428081	61560115	61743142	61721454	66257317	829236	1.3%
Loans to bank related parties and bank employees	D	405821	373446	631551	1155869	1375962	970141	239.1%
	F	4093297	1892592	2703396	2585234	2360374	-1732923	-42.3%
Provisions		-3936700	-3550789	-3056045	-3260188	-2996054	940646	-23.9%
Other assets		13420131	11407999	11783208	11068031	7651633	-5768498	-43.0%
Interest receivable	D	548761	564688	507468	782316	785522	236761	43.1%
	F	1938581	1916655	1351673	1089791	800162	-1138419	-58.7%
Fixed assets		15267624	14842551	15278604	15892942	15818497	550873	3.6%
Other securities		4355297	2874022	1744014	630150	461429	-3893868	-89.4%
Leasing, factoring		1628693	1956886	1684255	1534662	4119383	2490690	152.9%
Total balance sheet assets		243168682	238541873	257924944	267634516	282149632	38980950	16.0%
Liabilities								
Bank correspondent accounts	D	667542	487380	259342	343977	382245	-285297	-42.7%
	F	3599771	4969976	2493462	3006514	2600224	-999547	-27.8%
Demand liabilities	D	27921581	21428877	24800907	29888031	31940690	4019109	14.4%
	F	56591321	61767791	70887068	74189524	78466297	21874976	38.7%

Liabilities to banks	D	8105000	9449200	9959607	9666033	9050000	945000	11.7%
	F	12602500	11496832	7004632	6533883	7288727	-5313773	-42.2%
Deposits of individuals	D	3757978	3874629	4135235	4216983	4137482	379504	10.1%
	F	39458301	38789722	41310892	42857960	45550489	6092188	15.4%
Deposits of enterprises	D	6618260	7769298	10418179	9661029	7103583	485323	7.3%
	F	20547238	14975871	11950983	13832994	20820860	273622	1.3%
Other liabilities		23318357	21183549	26338138	23464938	23553066	234709	1.0%
Interest payable	D	399006	456284	426591	493882	371293	-27713	-6.9%
	F	1045613	992432	805433	755232	771364	-274249	-26.2%
Total balance sheet liabilities		204632468	197641841	210790469	218910980	232036320	27403851	13.4%
Equity								
Paid-in capital		34736349	38378831	36733379	37528781	36769005	2032656	5.9%
General reserves		4119766	4483766	4292686	4292687	4242383	122617	3.0%
Bank's own shares purchased back		-341562	-341562	0	0	0	341562	-
Undistributed profit (loss)	current period	-1877830	-5163658	1730362	3785632	6480851	8358681	-
	previous period	-673598	1321646	2052141	803742	614693	1288291	-
Total balance sheet equity		38536214	40900032	47755705	48723536	50113313	11577098	30.0%
Note :								
Collateral and guarantee received		193418611	202722506	213726573	231636114	236507065	43088454	22.3%
including: government securities		5994284	5361810	2919766	4835560	5598668	-395616	-6.6%
Written off	loans	18332634	19163841	12857066	12026061	9917368	-8415266	-45.9%
	receivables	6348902	6249745	3467327	3706580	3712817	-2636085	-41.5%
	interest	20779121	20578321	9841973	9628885	5363307	-15415814	-74.2%
Guarantees issued		6039997	8087986	10024997	7823212	4987041	-1052956	-17.4%
Collateral provided total		2726509	2121550	564081	566815	835540	-1890969	-69.4%
	including: government securities	1126489	535206	505601	509802	835540	-290949	-25.8%

Change in total capital

thousand AMD

	01.01.2004
Amount at the beginning of the period¹	
Total capital, including:	33 760 914
Core capital	31 380 759
Statutory capital	33 993 348
Note: number of shares sold	4 561
General reserves	4 083 766
Undistributed profit	(2 781 502)
Amount deducted from core capital	236 491
Long-term subordinated loan	-
Bank's own shares purchased back	(341 562)
Intangible assets (other than software)	(650 089)
Investment with statutory capital of other banks	25 800
Material assets not in use	1 202 342
Amount exceeding book value of material assets and book value of core capital	-
Additional capital	2 380 156
Revaluation reserves	2 410 188
Reserve generated from FX differences due to balance sheet consolidation	-
Other reserves	(30 032)
Long-term subordinated borrowing	-
Change during the period	
Total capital, including:	11 589 974
Core capital	11 999 032
Statutory capital	2 775 656
Note: number of shares sold	(2 182)
General reserves	159 379
Undistributed profit	9 812 802
Amount deducted from core capital	3 603 418

Long-term subordinated loan	-
Bank's own shares purchased back	341 562
Intangible assets (other than software)	1 166 878
Investment with statutory capital of other banks	416 758
Material assets not in use	1 265 714
Amount exceeding book value of material assets and book value of core capital	412 506
Additional capital	(409 058)
Revaluation reserves	(431 677)
Reserve generated from FX differences due to balance sheet consolidation	-
Other reserves	22 619
Long-term subordinated borrowing	-
Amount at the end of the period ²	
Total capital, including:	45 350 888
Core capital	43 379 790
Statutory capital	36 769 004
Note: number of shares sold	2 379
General reserves	4 243 145
Undistributed profit	7 031 300
Amount deducted from core capital	3 839 909
Long-term subordinated loan	-
Bank's own shares purchased back	-
Intangible assets (other than software)	516 789
Investment with statutory capital of other banks	442 558
Material assets not in use	2 468 056
Amount exceeding book value of material assets and book value of core capital	412 506
Additional capital	1 971 098
Revaluation reserves	1 978 511
Reserve generated from FX differences due to balance sheet consolidation	-
Other reserves	(7 413)
Long-term subordinated borrowing	-

¹ Data of 21 banks operating under the general supervision.

² Data of 19 banks operating under the general supervision.

Annex 4

Non-resident participation in the bank statutory capital

thousand AMD

	31.12.02	Change during the period	31.12.03
Statutory capital	34 309 252	2 197 169	36 506 421
including: non-residents	16 934 088	131 143	17 065 230
share of non-residents (%)	49.4%	- 2.6%	46.7%

Income and expense of banks

thousand AMD

	31.12.02	31.12.03	Change
Interest income			
Interest received from correspondent account	284 059	261 917	-7.8%
Interest received from resources placed with the Central Bank	423 775	472 784	11.6%
Interest received from resources placed with banks and other financial institutions	630 951	601 887	-4.6%
Interest received from loans provided to economy	14 502 850	15 956 529	10.0%
Interest received from overdraft	645 131	491 091	-23.9%
Interest received from credit cards	11 980	40 717	239.9%
Interest received from T-bills	3 086 299	3 583 888	16.1%
Interest received from repo agreements	319 294	318 642	-0.2%
Interest received from leasing	5 088	3 645	-28.4%
Other interest income	935 078	694 914	-25.7%
Interest income, total	20 844 505	22 426 014	7.6%
Interest expense			
Interest paid on correspondent accounts	76 407	15 173	-80.1%
Interest paid on bank accounts and demand deposits	458 284	381 196	-16.8%
Interest paid on resources from the Central Bank	485 836	636 953	31.1%
Interest paid on liabilities on repo agreements	138 478	32 736	-76.4%
Interest paid on resources from banks and other financial institutions	529 891	343 942	-35.1%
Interest paid on time deposits	5 398 720	4 512 406	-16.4%
Interest paid on resources from international financial institutions	467 239	303 463	-35.1%
Interest paid on overdraft	93	1 335	1335.5%
Interest expense on deposit insurance	0	225 297	100.0%
Interest on non-performing assets not collected	1 310 935	557 661	-57.5%
Other interest expense	292 659	363 138	24.1%
Interest expense, total	7 373 300	7 373 300	0.0%
Interest income, net	11 675 672	15 052 714	28.9%
Non-interest income			
Commission received	7 501 599	8 520 639	13.6%
Income from guarantees, acceptance and L/C operations, and trust management	296 676	347 919	17.3%
Net income from hedging derivatives	218	3 530	1519.3%
Net income from factoring	33 498	68 333	104.0%

Income from investment with other institutions	15 355	54 425	254.4%
Net income from sale of securities	112 744	236 431	109.7%
Net income from FX purchase and sale	2 236 048	2 501 603	11.9%
Positive (negative) exchange rate difference from FX revaluation	-120 092	-513 863	327.9%
Net income from disposal of fixed assets	-469 793	8 884	-101.9%
Net income from revaluation of fixed assets	-195 513	5 509	-102.8%
Fines and penalties received	744 815	590 799	-20.7%
Other non-interest income	1 517 615	1 266 558	-16.5%
Non-interest income, total	11 673 170	13 090 767	12.1%
Non-interest expense			
Salary and salary-equivalent pays (other remuneration and financing of social requirements)	5 389 896	5 886 662	9.2%
Business trip costs	251 408	337 150	34.1%
Contributions to Social Security Fund	712 904	684 018	-4.1%
Taxes, duties and other mandatory pays	746 620	805 375	7.9%
Amortization	1 846 546	1 826 832	-1.1%
Leasing charge for bank premises and other fixed assets	473 514	528 567	11.6%
Advertisement and representative costs	616 728	842 913	36.7%
Office and printing costs	330 824	352 905	6.7%
Audit and consultation services costs	255 042	204 322	-19.9%
Bank equipment maintenance costs	203 597	196 811	-3.3%
Transport costs	266 920	250 893	-6.0%
Communications charges	704 037	787 587	11.9%
Fines and penalties paid	130 259	54 194	-58.4%
Training costs	44 190	53 314	20.6%
Other non-interest expense	3 505 137	3 789 868	8.1%
Non-interest expense, total	15 477 622	16 601 410	7.3%
Non-interest income, net	-3 804 452	-3 510 643	-7.7%
Provisions to the general fund for loan and receivable loss	4 216 497	5 165 311	22.5%
Provisions to the special fund for loan and receivable loss	17 852 856	11 202 553	-37.3%
Provisions to the fund for securities loss	47 701	21 541	-54.8%
Provisions, total	22 117 054	16 389 405	-25.9%
Collection from the general fund for loan and receivable loss	4 025 248	4 635 761	15.2%
Collection from the special fund for loan and receivable loss	10 538 879	8 489 341	-19.4%
Collection from the fund for securities loss	13 650	28 350	107.7%

Collection, total	14 577 777	13 153 452	-9.8%
Assignments, net	7 539 277	3 235 953	-57.1%
Profit before tax	331 943	8 306 118	2402.3%
Profit tax	911 578	1 790 459	96.4%
Net profit	-579 635	6 515 659	-1224.1%
Dividends	6 899	2 343	-66.0%
Undistributed profit	-586 534	6 513 316	-1210.5%

Loan investments and receivables of banks

thousand AMD

	Up to 1 year		1 year and more		Total	
	AMD	FX	AMD	FX	AMD	FX
1. Loans, deposits, factoring, leasing, repo agreements, total (2+3)	21 565 930	58 618 230	13 900 314	34 955 705	35 466 244	93 573 936
1.1. Time assets	20 334 348	57 440 512	13 900 314	31 157 223	34 234 662	88 597 736
including:	16 470 760	34 863 434	13 791 334	29 166 947	30 262 094	64 030 382
interbank loans, deposits, factoring, leasing, repo agreements	350 000	21 425 756	0	1 301 809	350 000	22 727 565
1.2. Prolonged assets	666 496	314 609	0	3 798 482	666 496	4 113 091
including: loans	385 695	310 777	0	2 830 000	385 695	3 140 777
interbank loans, deposits, factoring, leasing, repo agreements	0	0	0	0	0	0
1.3. Overdue assets	565 086	863 109	0	0	565 086	863 109
including: loans	547 838	779 922	0	0	547 838	779 922
interbank loans, deposits, factoring, leasing, repo agreements	0	0	0	0	0	0
2. Loans to non-residents, deposits, factoring, leasing, repo agreements	622 159	22 034 104	1 965 953	2 598 077	2 588 112	24 632 181
2.1. Time assets	232 056	21 909 680	1 965 953	2 598 077	2 198 009	24 507 757
2.2. Prolonged assets	0	92 163	0	0	0	92 163
2.3. Overdue assets	390 103	32 261	0	0	390 103	32 261
3. Loans to residents, deposits, factoring, leasing, repo agreements, by branches, including:	20 790 705	36 245 341	12 087 427	32 696 414	32 878 132	68 941 755
3.1. Industry	4 912 626	8 312 771	4 913 815	11 632 262	9 826 441	19 945 033
<i>Ores and minerals</i>	22 824	1 118 700	9 335	110 313	32 159	1 229 013
<i>Energy</i>	1 853 450	2 471 778	2 380 900	4 040 399	4 234 350	6 512 177
<i>Food</i>	1 646 205	3 258 236	1 316 859	4 216 775	2 963 064	7 475 011

<i>Light industry</i>	261 664	545 275	89 602	432 391	351 266	977 666
<i>Chemicals</i>	34 726	52 526	9 856	150 970	44 582	203 496
<i>Construction materials</i>	225 391	211 517	332 488	681 283	557 879	892 800
<i>Precious items</i>	40 834	137 902	184 930	24 322	225 764	162 224
<i>Metallurgy</i>	22 308	399	23 756	484 213	46 064	484 612
<i>Machinery and electrical equipment</i>	206 296	135 236	61 460	116 979	267 756	252 215
<i>Other industries</i>	598 928	381 202	504 629	1 374 617	1 103 557	1 755 819
3.2. Agriculture	732 858	3 997 374	203 436	2 775 316	936 294	6 772 690
3.3. Construction	1 574 440	667 881	540 951	2 022 178	2 115 391	2 690 059
3.4. Transport and Communications	232 146	88 061	49 816	297 043	281 962	385 104
3.5. Trade	7 142 331	4 247 093	3 382 295	6 363 706	10 524 626	10 610 799
3.6. Public food and other service areas	669 261	249 027	396 076	1 387 066	1 065 337	1 636 093
3.7. Financial sector	2 500 735	5 732 963	547	53 376	2 501 282	5 786 339
3.8. Consumer loans	2 635 256	12 130 873	1 441 538	7 006 390	4 076 794	19 137 263
3.9. Other sectors of economy	391 052	819 298	1 158 953	1 159 077	1 550 005	1 978 375

Income and expense of banks

thousand AMD

	Non-performing assets		Post balance sheet residuary	
	AMD	FX	AMD	FX
Assets non-performing and written off to post balance sheet, total	1 982 143	3 549 349	3 245 959	9 104 104
1. Residents' assets non-performing and written off to post balance sheet, total	464 670	675 222	753 963	1 716 375
1.1. Industry, including:	13 160	0	170 087	0
<i>Ores and minerals</i>	0	0	0	136 955
<i>Energy</i>	224 190	286 441	359 369	542 422
<i>Food</i>	24 700	284 855	181 941	336 793
<i>Light industry</i>	0	19 618	170	184 520
<i>Chemicals</i>	4 000	0	0	6 940
<i>Construction materials</i>	124 350	4 081	10 102	514
<i>Precious items</i>	0	0	0	25 927
<i>Metallurgy</i>	2 000	39 619	0	393 936
<i>Machinery and electrical equipment</i>	72 270	40 608	32 294	88 368
<i>Other industries</i>	24 391	98 895	101 655	307 326
1.2. Agriculture	286 900	42 763	135 534	168 674
1.3. Construction	12 673	40 858	0	53 596
1.4. Transport and Communications	467 541	467 884	178 635	2 012 331
1.5. Trade	762	269 893	34 111	74 307
1.6. Public food and other service areas	0	0	1 510	16 923
1.7. Financial sector	260 423	1 173 912	172 059	1 873 938
1.8. Consumer loans	464 783	779 922	1 868 493	2 880 635
1.9. Other sectors of economy	1 314 166	178 053	80 381	8 597 035
2. Non-residents' assets non-performing and written off to post balance sheet, total	1 982 143	3 549 349	3 245 959	9 104 104

Annex 8

Provisioning for loans, receivables and post balance sheet items containing credit risk

Risk category	Loans		
	Amount	Reserves on loans granted	
		balance	%
1. Standard	116 311 522	1 163 114	1.00%
2. Watch	4 183 038	418 301	10.00%
3. Sub-standard	869 127	173 820	20.00%
4. Doubtful	918 881	459 443	50.00%
Total	122 282 567	2 214 677	1.81%

Risk category	Receivables		
	Amount	Reserves on receivables	
		balance	%
1. Standard	70 429 076	704 303	1.00%
2. Watch	359 879	35 988	10.00%
3. Sub-standard	62 119	12 423	20.00%
4. Doubtful	17 210	8 606	50.01%
Total	70 868 284	761 320	1.07%

Risk category	Post balance sheet items		
	Amount	Reserves on post balance sheet items	
		balance	%
1. Standard	16 025 363	160 281	1.00%
2. Watch	330 672	33 067	10.00%
3. Sub-standard	27 159	5 432	20.00%
4. Doubtful	48 653	24 327	50.00%
Total	16 431 847	223 106	1.36%

Funds flows of banks

01.01.2004

Money flow from operational activity	
Net money flow from operational activity	38 879 263
Net money flow before a change in operational assets and liabilities	20 997 434
Interest received on loans	16 548 750
Net commission received	5 985 337
Net income from repo agreements	159 078
Net income from marketable securities	239 344
Net income from FX purchase and sale	2 340 676
Interest paid on accounts and deposits attracted	-5 218 436
Income from leasing and factoring operations	68 545
Interest received on deposits allocated	1 028 683
Interest paid on loans attracted	-1 083 521
Interest paid on financial activity	-25 013
Salary and salary-equivalent pays	-5 507 685
Taxes paid	-1 801 436
Collection of loans written off	3 601 051
Collection of receivables written off	395 444
Income from investment activity	4 264 577
Dividends received	2 040
Net money flow from a change in operational assets and liabilities	17 881 829
Decrease (increase) in loan investments	-30 430 902
Increase (decrease) in deposits attracted	51 600 612
Decrease (increase) in securities held through repo agreements	1 343 198
Increase (decrease) in securities sold through repo agreements	-713 850
Decrease (increase) in marketable securities	-1 169 577
Decrease (increase) in factoring operations	-1 834 770
Decrease (increase) in assets provided for leasing	0
Net money flow from other operational activity	-912 882
including: on derivatives	-1 374
including: fines and penalties paid	218 083
Money flow from investment activity	
Net money flow from investment activity	-10 403 035
Decrease (increase) in securities held up to maturity	-1 486 100
Decrease (increase) in investment in non-term securities	-636 554
Decrease (increase) in deposits with other banks	-3 560 348

Disposal (acquisition) of fixed assets and non-tangible assets	-4 812 847
Net money flow from other investment activity	92 814
Money flow from financial activity	
Net money flow from financial activity	6 154 843
Dividends paid	-1 511 611
Increase (decrease) in loans received from the Central Bank	1 500 000
Increase (decrease) in loans received from banks	-177 075
Increase (decrease) in other borrowings	852 439
Increase (decrease) in proceeds from leasing	20 460
Increase (decrease) in securities issued by bank	562 266
Shareholder contribution to statutory fund	5 126 038
Net money flow from other financial activity	-217 674
FX exchange impact on cash funds and their equivalents	-261 207
Net growth of cash funds flow	34 369 864
Cash and cash equivalents net, at the beginning of the period	68 554 513
including: funds with a limited use	718 986
Impact of indicators of the banks, removed from the banking system, on the cash and cash-equivalents	-5 253 996
Cash and cash equivalents net, at the end of the period	97 670 381
including: funds with a limited use	1 411 074
Note:	
1. Assets written off to post balance sheet during a quarter (year)	8 030 638
including: loans	6 443 335
receivables	1 586 971
2. Repayment of assets written off to post balance sheet during a quarter (year)	5 196 956
including: loans	4 797 689
receivables	399 267
3. Interest written off to post balance sheet during a quarter (year)	1 012 412
4. Repayment of interest written off to post balance sheet during a quarter (year)	1 224 503

Prudential economic standards of banks

	31.12.02	31.03.03 ²	31.06.03 ³	30.09.03 ³	31.12.03 ¹
Total capital adequacy	30.5%	30.9%	39.2%	34.5%	34.3%
Core capital adequacy	28.8%	29.2%	37.4%	32.7%	32.7%
Total liquidity	44.5%	46.2%	47.3%	49.0%	48.8%
Current liquidity	108.8%	112.4%	114.7%	112.9%	109.9%
Maximum risk on a single borrower	27.4%	24.7%	17.2%	15.2%	13.8%
Maximum risk on a bank related party	0.9%	2.0%	1.7%	2.0%	1.8%
Maximum risk on all bank related parties	2.9%	4.1%	3.4%	4.7%	4.7%

¹ Data of 19 banks operating under the general supervision.

² Data of 21 banks operating under the general supervision.

³ Data of 20 banks operating under the general supervision.

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