

“Registered”

By the Ministry of Justice of the RA

On October 25, 2016

State Registration Number 05016346

THE BOARD OF THE CENTRAL BANK

OF THE REPUBLIC OF ARMENIA

ORDINANCE No 160-N

27.09.2016

On approving Regulation 20/04

“On Minimum requirements on internal control for financial groups”

Intending to clarify the implementation of internal controls at the financial group level;

Pursuant to the Article 20(kb) of the Law of the Republic of Armenia “On the Central Bank of the Republic of Armenia”;

In conformity with the provisions of Article 20(e) of the Law of the Republic of Armenia “On the Central Bank of the Republic of Armenia”, Article 16 of the Law of the Republic of Armenia “On Legal Acts”, the Board of the Central Bank of the Republic of Armenia

decides:

1. To approve Regulation 20/04 “On Minimum requirements on internal control for financial groups” in conformity with the Annex of this Ordinance (attached).
2. This Ordinance shall come into force on January 1, 2017.

**Chairman of the Central Bank
of the Republic of Armenia**

A. Javadyan

October 5, 2016

Yerevan

Annex

Approved by
The Board of the Central Bank
Of the Republic of Armenia
September 27, 2016, Ordinance No 160-N

REGULATION 20/04

MINIMUM REQUIREMENTS ON INTERNAL CONTROL FOR FINANCIAL GROUPS

CHAPTER 1. GENERAL PROVISIONS

1. This regulation shall establish minimum requirements on internal control for Armenian financial groups and Armenian financial groups the part of International financial groups (hereinafter financial groups) recognized by the Central Bank. Armenian financial groups and Armenian financial groups the part of International financial groups have the meaning defined by the normative legal acts of the Central Bank.
2. Internal control system of the financial group must be mainstreamed within the organizational structure of the financial group members in order to provide effective implementation of internal controls at the level of financial group.

CHAPTER 2. INTERNAL LEGAL ACTS OF THE FINANCIAL GROUP

3. Internal control system of the financial group shall be outlaid in the internal legal acts of the financial group, such as rules, procedures, regulations, instructions, guidelines and other acts.
4. Subject to the consent of all members of the financial group, the rules, procedures, regulations, instructions, guidelines and other acts referred to in paragraph 3 of this Regulation, shall be endorsed by:
 - 1) Relevant bodies of all financial group members authorized to endorse internal legal acts (collectively); or

- 2) Relevant body of financial group responsible entity authorized to endorse internal legal acts; or
 - 3) A body equally representing all financial group members (hereinafter group of representatives).
5. The responsible entity of financial group submits to the Central Bank internal legal acts of the financial group (including internal legal acts preventing conflicts of interests within the group) within 10 working days following their endorsement (introduction of amendments, supplements, redrafting).

CHAPTER 3. COORDINATION OF FINANCIAL GROUP ACTIVITIES

6. Financial group internal legal acts shall establish terms and conditions of coordination of financial group activities as defined in paragraph 7 of this Regulation.
7. Coordination of financial group activities includes the following functions:
 - 1) Implementation of internal controls at the level of the financial group;
 - 2) Calculation of financial group prudential standards set forth by the Central Bank normative legal acts and submission thereof to the responsible entity;
 - 3) Preparation of financial group reports set forth by the Central Bank normative legal acts and their submission to the responsible entity.
8. Financial group members shall provide all necessary information, to entities responsible for performing functions set in paragraph 7 of this Regulation.
9. The function or functions set in paragraph 7 of this Regulation may be performed either by a separate member of the financial group or at the financial group level.
10. While performing the functions set in paragraph 7 of this Regulation cases of conflicts of interests must be reduced to the minimum possible level.
11. While performing the functions set in paragraph 7 of this Regulation the financial group ensures sufficient authority, independence and resources to effectively perform the duties related to particular functions, as well as to achieve required results.
12. Performer (performers) of the functions set in paragraph 7 of this Regulation shall have the rights and power:

- 1) to express independent and objective opinion regarding revealed problems, actual and possible infringements;
- 2) to control the implementation process of the stipulated remedy measures and recommendations as needed;
- 3) to contact at their discretion any of the financial group member staff; obtain documents and information necessary for the performance of their duties.

CHAPTER 4. INTERNAL CONTROL SYSTEM

13. Financial group internal control system is an integrated complex including financial groups' risk management system, reporting system, compliance function, as well as oversight measures over them.
14. Core targets of financial group internal control system are the following:
 - 1) identification and management of the inherent risks of financial group;
 - 2) provision of necessary information flows between financial group members, coordination of those information flows and follow-up (informational target);
 - 3) ensuring compliance with the laws and other normative legal acts of the Republic of Armenia, internal legal acts of the financial group (rules, regulations, procedures, instructions, guidelines, etc.), legal requirements on Anti-money laundering and Terrorism financing (legal compliance target).
15. Internal control system and its elements shall be evaluated and revised as needed at a frequency set out by the financial group, but not less than every 2 years; whereas in the event of environmental changes, as well as in case of identification of new or neglected significant risks, systemic shortages and significant gaps, in a reasonable timeframe after the identification. Any significant revisions and their rationale, or any substantiation on unfeasibility of revision shall be duly documented.
16. Environmental changes as laid down in paragraph 15 of this Regulation, shall at least include changes in the composition and structure of the financial group and any other alterations of the environment, which may have substantial impact on the financial group.

17. The Performer of the function laid down in paragraph 7(1) of this Regulation shall prepare a report on the riskiness of the financial group at a frequency set out in the internal legal acts of the financial group, but at least on a quarterly basis, and deliver it to:
- 1) the group of representatives (as available); or
 - 2) the responsible entity of the financial group in the case defined in paragraph 4(2) of this Regulation; or
 - 3) the boards of all financial group members.
18. In the event of breach of the legal framework regulating financial group activities or internal legal acts of financial group, the body performing functions specified in paragraph 7(1) of this Regulation shall be accountable to:
- 1) the responsible entity;
 - 2) the board of the incompliant financial group member. Furthermore, subject to the consent of the incompliant financial group member, group of representatives (as available) or boards of all financial group members are notified about the breach.
19. Financial group members shall ensure access of their staff to the internal legal acts outlining financial group internal control system.

CHAPTER 5. RISK MANAGEMENT SYSTEM

20. Financial group risk management system shall be comprehensive and in line with the areas of financial group activities and the risks associated to these activities.
21. Financial group risk management system at the group level shall at least include:
- 1) risk management strategy, which shall define general approaches (targets) of risk management by the financial group. During the design of the risk management strategy at the financial group level, at least the following shall be considered: business plans approved by the authorized bodies of financial group members and peculiarities of their business processes, including the outsourced functions of the financial group members.
22. Risk management system of the financial group shall at least provided for identification, measurement, monitoring, supervision and stress testing of the following risks:
- 1) credit risk;

- 2) credit concentration risk;
 - 3) intragroup transactions risk;
 - 4) operational risk;
 - 5) risk of contagion;
 - 6) Money laundering and terrorism financing risk;
 - 7) Insurance underwriting risk (if at least one member of the group is an insurance company).
23. Credit risk is the probability that the transaction counterparty of a financial group member will breach the terms of the contract concluded with the financial group member, causing adverse impact on the financial group's profit and (or) equity.
24. Credit concentration risk at the level of financial group is the probability that same party, which has concluded transactions with the different members of the financial group, will breach the terms of the contract concluded with one or several of them, causing adverse impact on the financial group's profit and (or) equity.
25. Financial group shall design a methodology for assessment the credit risk and credit concentration risk as specified in paragraphs 23 and 24 of this Regulation, which will enable to assess the credit risk concentration at the level of financial group by the sectors of economy, geographic location, industry or sector of the activities of financial group counterparty, and risk per borrower.
26. Intragroup transactions risk is the probability that transactions concluded between the financial group members may by their nature or volume cause adverse impact on the financial group's or one of the financial group member's profit and (or) equity.
27. Operational risk is the probability of losses as a result of poor or failed internal processes, systems and human factor or external factors, which causes adverse impact on the financial group's profit and (or) equity. Operational risk includes the legal risk as well.
28. Risk of contagion emerges when there is a probability that the problems in one segment of the group may be conveyed to the other members of the group due to the loss of customers' confidence, notwithstanding the fact that there are no financial relations between the group members.
29. Money laundering and terrorism financing risk is the fact proving the danger of money laundering and terrorism financing and its possibility, which may be described by

countries or geographic location, customer type, business relationship or transaction type, service type or other criteria.

30. Financial Group shall identify and assess the existing and potential risks of money laundering and terrorism financing as described in paragraph 22(6) of this Regulation and shall have a policy of mitigation and effective management of the identified risks, control mechanisms and procedures. Financial group shall periodically, but not less than once a year review its existing and potential risks of money laundering and terrorism financing. Financial group in addition to other money laundering and terrorism financing risks, shall identify and assess existing and potential risks connected to the provision of new types of services or the delivery methods of these services, as well as to the implementation of new or developing technologies, respectively before the provision of new types of services or the launch of their delivery methods or the implementation of new or developing technologies.
31. Insurance undertaking risk is the probability that the calculated insurance fees and technical provisions will not be enough to meet insurance obligations according to insurance contracts, which will have a negative impact on financial group's capital and (or) profit.
32. The stress testing for the risks mentioned in paragraph 22 of this Regulation should be carried according to the schedule defined by the financial group internal legal acts.