

***THE CENTRAL BANK OF ARMENIA
STRATEGY 2012 – 2014***

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STAGES OF DEVELOPMENT OF THE CENTRAL BANK

- **Introduction of the national currency:** In 1993 the Republic of Armenia Law on “The Central Bank of the Republic of Armenia” was adopted, and the National Bank was re-named into the Central Bank of the Republic of Armenia. The national currency, the Dram, was put into circulation in the territory of the Republic of Armenia under Resolution No. 15 of 19.11.2003 of Supreme Council of the Republic of Armenia.
- **Creation of monetary policy:** In 1994 for the first time, the Central Bank formulated a monetary policy program in that way adopting the strategy to curb inflation.
- **Adoption of banking legislation:** In 1996 the National Assembly of the Republic of Armenia adopted the following laws in order to regularize the Armenian banking sector, as follows: Law on the Central Bank of the Republic of Armenia, Law on Banks and Banking, Law on Bank Bankruptcy, Law on Bank Secrecy. Maintaining price stability has become number one priority for the Central Bank, and a new framework for banking system rehabilitation measures was established.
- **Creation of national payments and settlements system:** In the period 1996 – 2001 interbank electronic payments system BANKMAIL, government securities accounting and settlements system BOOKENTRY were introduced. The SWIFT system started to be widely used in international payments. In the meantime, efforts were spent launch the national payments and settlements system in compliance with international standards by creating the unified payment and settlement system ArCa (“Armenian Card”).
- **Improvement in the banking legislation framework; creation of infrastructures:** In the period 2002 - 2004 considerable improvements and innovations were made to the banking legislation, giving birth, among others, to the establishment of guarantee of deposits of individuals. Further, the Central Bank took on the function for combating money laundering and terrorism financing. The process of rehabilitation of the banking sector was completed and Armenian banks availed themselves of increased levels of replenishment of capital.
- **Central Bank as megaregulator and responsible for financial stability:** In 2006 a single framework for risk-based financial regulation and supervision was introduced in Armenia in compliance with international practice. The Central Bank

was given authority to regulate and supervise activities of all participants of the financial sector. So, the Central Bank took on the function of megaregulator along with responsibility for maintaining financial stability. A corporate governance culture was introduced to the financial sector, the banking system in particular. Banks became increasingly service-friendly, in a sounder environment of competitiveness.

- **Inflation targeting:** In 2006 the Central Bank moved to a fully-fledged inflation targeting strategy.
- **Development of financial sector; institutional and infrastructural reforms:** In the period 2007 - 2011 the Central Bank initiated legislative reforms pertaining to the financial system operations. This set up a ground for reforms to implement in the non-bank financial sector, namely insurance and capital markets as well as paved a way to implement reforms in infrastructures. NASDAQ OMX, one of the best operators worldwide made its entry to the Armenian market. Further, a consumer interest protection component was established; the office of financial system mediator started its operations; a compulsory third party motor liability insurance scheme was introduced.

Main Development Direction Outlined by the Central Bank for the Period 2012 - 2014: Diversification of the financial sector. Keep institutional and infrastructural reforms going on in the financial sector in order to make it even more competitive and modern.

Mission of the Central Bank

The Central Bank of the Republic of Armenia is an independent state authority the ultimate task of which is maintaining price stability in the territory of the Republic of Armenia.

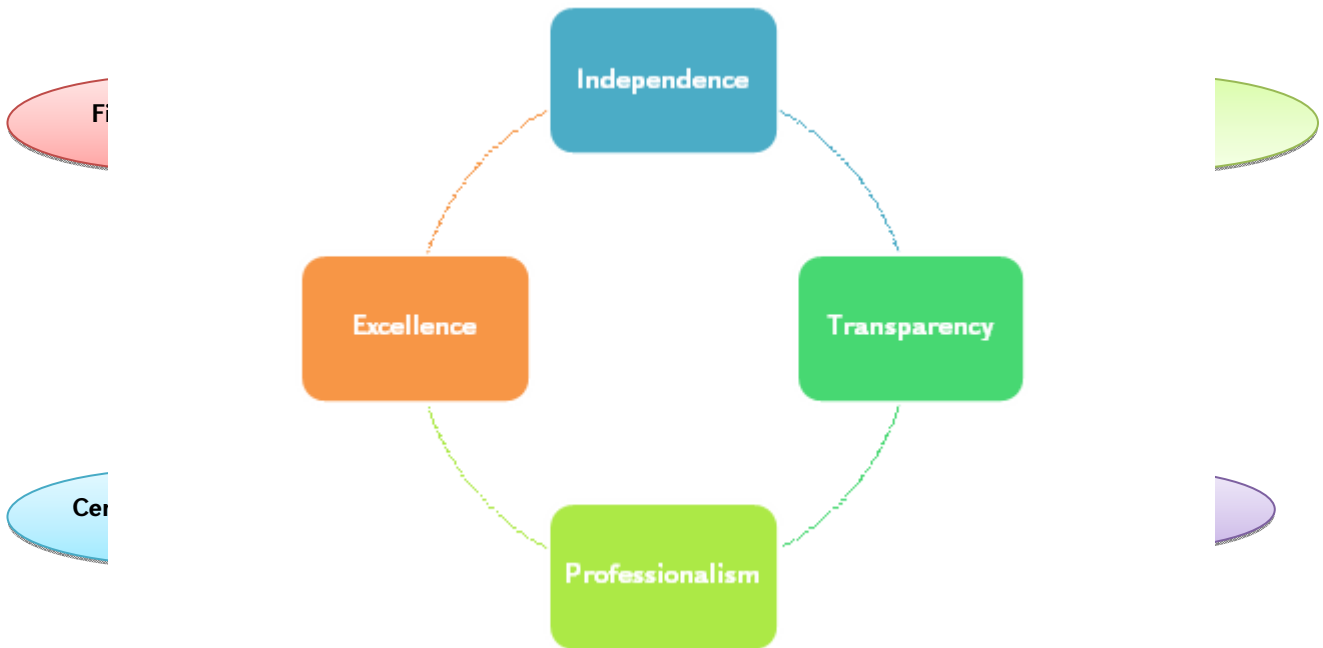
Mission of the Central Bank is to:

- ✓ be a prestigious, transparent, independent, knowledge-based and effective entity that understands and appreciates development trends in international financial community;
- ✓ maintain institutional capacities in order to promptly respond to changes in economic landscape and effectively influence economic processes;
- ✓ always support a sustainable macroeconomic development of Armenia while remaining a key partner to the Government in facing economic challenges.

Key tasks of the Central Bank are to:

- maintain stability of the financial sector;
- provide issuance of national currency and ensure cycle of it;
- combat money laundering and terrorism financing;
- manage international reserves of the Republic of Armenia;
- regulate and oversee other areas of competence as provided for under the Republic of Armenia Constitution and Republic of Armenia laws.

Values and Beneficiaries of the Central Bank



VALUES OF THE CENTRAL BANK

Independence: The sole founder of the Central Bank is the Republic of Armenia. The Central Bank is independent from state authorities of the Republic of Armenia in implementing its activities in the context of setting targets and deciding on the tools to achieve these targets. Independence is needed in order to implement effective policies aimed to maintain price and financial stability. In doing so, the Central Bank makes its contribution to a sustainable economic growth in a longer run.

Transparency: The Central Bank believes that transparency is a necessary and key condition for its accountability and independence. The Central Bank understands how an effective communication is important in the way of being trusted by and perceptible to the public in every aspect of policies it carries out. Consistence in actions is aimed to enhance people's confidence in the Central Bank as an open and transparent structure.

Excellence: In fulfilling its objectives, the Central Bank is in pursuit of being initiator of and taking lead in reforms as well as it faces challenges and responds to international developments. Studying and introducing international experience to all areas of the Central Bank activity is an ongoing process.

Professionalism: Engaging a staff with extensive knowledge and skills required for high performance, retaining talent and nurturing their lifelong growth through the path of professional development and career is a top priority to the Central Bank. While stressing the importance of using best international experience and advanced approaches, the Central Bank always encourages initiative and creative thinking, it creates fine conditions and environment for staff training so that they could get international qualification certificates and continue professional growth.

BENEFICIARIES OF THE CENTRAL BANK

Financial sector: The policy of the Central Bank is directly reflected in the conduct of the financial sector participants and, therefore, should be perceptible to them for increased effectiveness. As a regulatory and supervisory authority, the Central Bank always seeks to be impartial and fair to the financial sector participants while making sure a level-playing-field is in place.

Society: While communicating to the public the Central Bank pursues to create expectations adequate to the policy on the one hand, and make its policy available in a most understandable way on the other. In doing so, the Central Bank gives impulses to the public and economic agents so that it helps them to make informed decisions.

Partners: The Central Bank cooperates with state authorities of the Republic of Armenia – President Administration, Government Assembly and its commissions, among others. Also, the Central Bank uses competence to represent interest of the Republic of Armenia in international financial institutions, central banks and other banks in different parts of the globe.

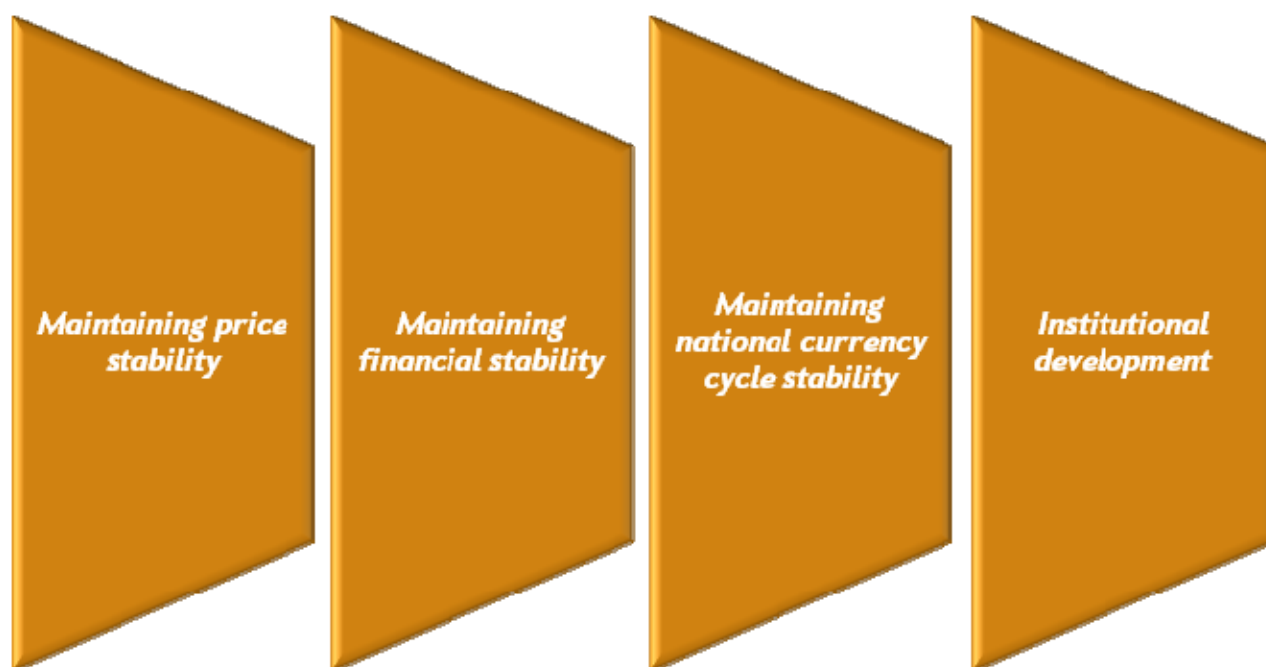
Central Bank staff: Human resource is the key asset of the Central Bank. Staff commitment to the values and mission as well as dedication to using their knowledge and skills in fulfillment of the tasks and goals of the Central Bank is key pledge of effectiveness and success of the Central Bank's activity. So, as a beneficiary, the staff of the Central Bank has an invaluable contribution in implementing tasks under the strategy of the Central Bank.

VISION OF THE CENTRAL BANK

Armenia in medium- and long-term perspective. In view of maintaining sustainable economic growth and integration to global markets, the Central Bank also pursues to having a key role in the regional context. In the period 2012 - 2014 the Central Bank will spend efforts in introducing best international experience to the financial sector while maintaining diversity and consistent development in the sector.

DIRECTIONS OF STRATEGIC DEVELOPMENTS OF THE CENTRAL BANK

For the period 2012 - 2014 the Board of the Central Bank has a blueprint for strategic development in the following areas:



Maintaining Price Stability

The Central Bank competence in maintaining price stability: carrying on implementing such a monetary policy under the inflation targeting strategy that keeps prices stable and anchors people's inflation expectations within the inflation target, while creating requisite conditions for macroeconomic stability and sustainable economic growth in the long-run.

1. Current circumstances

The Central Bank implements monetary policy based on principles laid down in inflation targeting strategy and floating exchange rate policy. Keeping prices stable under inflation targeting strategy is primary long-term goal of the monetary policy. To achieve this goal, the Central Bank makes sure there is high level of transparency and accountability by making monetary policy programs, tasks and goals and the ways how to achieve them publicly available.

Steered by the above principles, in the face of prevailing supply shocks and second-round effects and inflation expectations, the Central Bank currently implements such a policy of price stability in medium-run that is most understandable to people.

2. Main development goals

- Continue improving the forecasting and policy analyses system and its methodology in the framework of inflation targeting strategy by further introducing best international experience and using new quality information.
- Implement open, transparent monetary policies that shape steady inflation expectations and are most understandable to people.
- Enhance confidence of general public in the Central Bank and anchor inflation expectations within the inflation target in the face of changing nature of inflation and inflation developments on the whole.

3. Expected outcome and policy action

<u>Expected outcome</u>	<u>Policy action</u>
Maximum accuracy in and rationale for forecasts	Improve the forecasting and policy analyses system <ol style="list-style-type: none">1. Expand the main monetary policy model and develop it consistently by including behavioral equations of economic agents in best harmony with inflation targeting principles, peculiarities of the Armenian economy and micro-bases.2. Continued development of short-term monetary policy models and forecast and analysis models.3. Increase the scope and role of surveys with regard to the forecasting and policy analyses system, placing a greater focus on queries that are more addressing.

<p>Boost reputation of the Central Bank; implement monetary policy that is most perceptible to people</p>	<p>Take measures aimed to increase the people's perception of the nature of inflation, what causes it and what kind of monetary and currency policies are to be implemented.</p>
<p>Making channel of transmission stronger by the use of monetary policy instruments of the Central Bank</p>	<p>Take measures aimed to develop Armenia's money markets.</p>

Maintaining Financial Stability

The Central Bank competence in maintaining financial stability: implementing such a regulatory and supervisory policy under which the financial sector is able to offer a sufficient level of liquidity, uninterrupted operations and transfers and full possibility for investment of savings even in the face of emergence and structural reforms.

1. Current circumstances

The banking system which holds more than 90 percent of assets of the financial sector has a large share in overall financial sector. So, in the financial stability assessment point of view, disclosure and evaluation of risks to the activity and operations of the banking system is vital. In recent years the Central Bank has taken coordinated anti-crisis measures to assess, monitor and respond to potential risks deriving from domestic and external economies, financial markets, frameworks and infrastructures. As a result, adverse effects of the global financial and economic crisis on the Armenian financial sector were insignificant and no financial establishment faced any solvency problems. At the same time, insurance companies, securities market participants and other financial market elements are small enough, and their possible impact on financial stability is estimated to have been low. However, assets of insurance companies have grown by 51 percent thanks to the compulsory third party motor liability insurance scheme.

The regulatory and supervisory framework of the financial sector remains at leader positions in the regional context. Projects, both carried out and underway, covering such aspects as protection of consumer interest and raising financial literacy of households provide additional preconditions for increased rates of penetration to financial services and products and deeper financial intermediation.

2. Main development goals

- Create a sustainable framework of regulation and supervision in line with best international experience and criteria that would best combine risks to the financial system (stability) with the advancement of the financial system. Further align regulatory field of financial services and products with the EU directives as part of Armenia’s commitment to integrating to the European Union and in the framework of the EU–Armenia Association Agreement. Create an appropriate framework to combat money laundering and terrorism financing, in line with international standards.
- Design a financial stability framework to ensure effective systems are in place for evaluation of potential risks threatening financial stability and crisis management.
- Implement reforms in compliance with best international practice and under a single philosophy to ensure tantamount and balanced development of financial institutions, financial markets and financial infrastructures concomitant with raising financial intermediation.
- Develop a framework designed to increase consumer protection and financial literacy and awareness levels of households, in compliance with best international practice.

3. Expected outcome and policy action

<i>Expected outcome</i>	<i>Policy action</i>
Bring regulatory and supervisory field of financial sector in compliance with best international experience	<ul style="list-style-type: none"> - Align, on a gradual basis, financial services legislation with the EU directives and international instruments in observance of requirements laid down in the EU–Armenia Association Agreement to be concluded. - Improve the risk-based supervision framework and design and implement a consolidated supervision framework. - Introduce, on a gradual basis, core principles of Basle 2 and Basle 3 frameworks. - Introduce, on a gradual basis, core principles of Solvency 1 and Solvency 2 frameworks. - Comply, on a gradual basis, with principles and criteria determined by Basle Committee on Banking Supervision, International Association of Insurance Supervisors and International Organization of Securities Commissions. - Create a single information environment for, and implement reforms in, the area of combating money laundering and terrorism financing.
Effective systems in place for maintaining financial stability and crisis management, in line with best international experience	<ul style="list-style-type: none"> - Improve methodology for assessment of risks pertaining to the financial system. - Develop concepts for crisis management. - Organize simulations and develop an emergency plan. - Introduce and develop a system designed to assess risks, through macro-prudential analyses, transmitting to the financial system from non-financial system.

<p>Raise financial intermediation through new financial institutions, financial infrastructures, instruments and services</p>	<ul style="list-style-type: none"> - Develop a comprehensive financial system development concept. - Work on introducing non-cash and electronic financial services and their gradual development. - Design and gradually introduce 'hybrid' and stock exchange trades 'T+3' systems. - Work on creating a secondary mortgage market, in particular making the mortgage ownership simpler and less costly, and issue mortgage-backed securities. - Work on designing and developing collective investment schemes, including cumulative pension system. - Measures called to develop the capital market, in accordance with the program developed in cooperation with NASDAQ OMX.
<p>Develop consumer rights protection and financial literacy framework targeted to various audiences</p>	<ul style="list-style-type: none"> - Improve the regulatory and supervisory framework for market conduct, including making a clear distinction between actions for fair financial market and preventive actions. - Develop and improve the legislative framework for protection of consumer interests. - Develop a national strategy for financial literacy of households. - Carry out explanatory/educational campaigns on pension reforms, types of mandatory insurance and other financial services and products.

Maintaining National Currency Cycle Stability

The Central Bank competence in maintaining national currency cycle stability: implementing such a regulatory, organizational and supervisory policy so that it satisfies all economic agents' demand for unhindered flow of cash for whatever amount, nominal, quality and timeframes.

1. Current circumstances

During 2010 the Central Bank opened its new cash center which is equipped with state-of-the-art facilities for client service, cash processing and maintenance. Latest technologies for organizing flow of processes as well as automated systems and other conveniences for re-calculation, sort-out, packaging and destruction of cash are in place.

To improve cash service of clients, the Central Bank continued efforts to further get its operations automated. In the period 2009 - 2010 a new electronic system was in place that facilitates the flow of documents among the Central Bank, commercial banks and collection services as well as between the Central Bank and the Ministry of Finance.

Using best international practice and taking watch of the latest developments in the world of numismatics, the Central Bank carries out identification of the series of the Armenian banknotes to figure out what principles it needs for the design and security features for the banknotes, which in turn would facilitate the checking of authenticity.

In 2010 the banknote with nominal value of 100000 drams earned an international prize in the nomination “Banknote of the Year” for compliance with printing standards , effective production costs, state-of-the-art security features combined with harmonious design and high artistic value.

The Central Bank started new issues of investment notes and commemorative collector coins. Exhibitions were organized in some regions of the Republic of Armenia intending to familiarize people with the history of Armenian money circulation.

2. Main development goals

- Reduce risks that appear in the system of cash money cycle, in compliance with best international practice, through automation of all possible cash transactions and information flows pertaining thereto.
- Build capacity for review of cash money cycle and improve methodology to forecast the volumes for replenishment of reserves of the Armenian currency, in compliance with best international practice and through automation of the use of quality (accurate, efficient and complete) information and calculations.
- Raise effectiveness in the fight against money fraud through expanding technical facilities that detect authenticity of banknotes as well as effective approaches as to keeping households aware of security features of notes and coins.
- Supply money cycle with fit and proper notes and coins and develop and introduce effective mechanisms of control over them.
- Broadcast national, historic, cultural and spiritual values as well as satisfy numismatic demand of collectors in Armenia and abroad through issuance of commemorative coins, collector coins.

3. *Expected outcome and policy action*

<i>Expected outcome</i>	<i>Policy action</i>
Reduce risks that appear in cash money cycle; collect quality information on cash money cycle; build capacity for review of cash money cycle	Introduce a single cash management information system in the Republic of Armenia; automation of information flows pertaining to cash money cycle.
Supply money cycle with fit and proper notes and coins	Expand technical facilities for cash processing.
	Take measures to raise households' awareness of security features of notes and coins, their solvency criteria and to increase their ability to recognize main methods of counterfeits.

Institutional Development

The Central Bank competence in institutional development: serve as an internationally reputable entity and as a full partner in international relations while being an independent, transparent, perceptible organization which is able to implement economic policies based on knowledge and research; make sure professional and research potential of the Central Bank is enhanced and resources are effectively mobilized.

1. Current circumstances

Following international trends in central bank governance, the Central Bank is always for a streamlined governance structure, with its effective and necessary mechanisms in place. In particular, the Bank has moved to an electronic document flow regime; done work to develop information security management system and align it with international criteria; approved business continuity management strategy.

The Central Bank remained committed to recruiting young specialists, improving qualification and making the best use of their potential. Appropriate resources were used to support professional development and lifelong training of the staff of the Central Bank. In particular, more fields were chosen for international certification to professional qualification, and best staff members having taken exams successfully were encouraged. To amplify staff motivation, steps were taken to improve evaluation of job performance and bring it in compliance with best international experience.

There is an economic research unit in place which is responsible for macroeconomic and microeconomic research. Along with that, the unit is engaged in studying modern economic theories and international experience of applied economics. Best specialists with research capacity from leading higher educational establishments of Armenia and foreign countries are invited to participate in the work of the economic research unit of the Central Bank.

2. Main development goals

- Make sure structure and governance of the Central Bank are streamlined.
- Increase effectiveness of the work by involving, retaining and motivating best staff and talent; serve as an entity that effectively manages personnel and uses appropriate resources for advancement of professional potential in a knowledge-based environment.
- Be an entity that encourages studying, research, analyses while remaining dynamic enough to respond to changes in economic environment and influence economic processes effectively.
- Restructure the Central Bank functions in legal, financial, information and logistics areas so that they are in best compliance with international standards and criteria.
- Make sure services provided by the Central Bank are complete and valuable.
- Develop a new PR strategy to make public disclosure of Central Bank functions and achievements even more accessible to the general public.

3. Expected outcome and policy action

<u>Expected outcome</u>	<u>Policy action</u>
Make sure structure and governance of the Central Bank are streamlined and business continuity management is in place	Have mechanisms in place that make regular review and analyses of the Central Bank structure and operations, aimed at reducing risks, increasing effectiveness and making sure business continuity is in place.
Effective taking on the Central Bank functions with least amounts of risk and work intensity	Have information and management systems in place, in compliance with modern requirements and criteria.
Increase effectiveness of decision-making in the context of policies of the Central Bank	Expand capacities for research at macro- and micro-levels and such other capacities for review and analyses and forecasts.
Make sure business continuity management is in place	Boost up reserve and security facilities of the Central Bank.

<p>Make Central Bank operations more understandable to general public</p>	<p>Use the visitor center of the Central Bank for general public.</p>
<p>Implement strategic management of personnel of the Central Bank, in line with best international experience and modern approaches</p>	<p>Update staff recruitment policies, in line with best international experience and modern approaches; improve mechanisms for staff training policy and evaluation of training outcome.</p>
<p>Amplify knowledge potential of the Central Bank and increase effectiveness of state economic policy</p>	<p>Establish and utilize a training and research center in Dilijan, Armenia (see Appendix).</p>

Establishing a Training and Research Center

To increase the effectiveness of research work, the Central Bank intends to expand the research staff, which will then serve a basis for an economic research and education center at the financial and banking complex which is under construction in Dilijan, Armenia. The center has ambition to become an important institution in the regional context, have databanks utilized by similar international research establishments. Measures will be taken to build new, up-to-date databanks which will be a stimulus for Armenian researchers and their foreign counterparts to launch applied works regarding the Armenian economy. Construction of the center is expected to be completed before the end of this strategic cycle, and it will enable to house the following events:

- Creation of a training center where training programs regarding economics and finances will be carried out in compliance with international requirements and criteria, in particular:
 - it will house scientific and educational events through involvement of internationally prestigious scientific and financial institutions and well-known scientists. Invited experts are expected to launch research work in collaboration with the economic research bloc of the Central Bank;
 - post-graduate studies are expected to be organized in collaboration with the American University of Armenia;
 - training and certification are expected to be arranged covering topics such as project management and financial engineering.
- Launching research works by the center aimed at increasing effectiveness of state economic policies.
- Launching research works aimed at improving international competitiveness of the financial sector.
- Carrying out monitoring of the developments of the markets which are critical to Armenia.