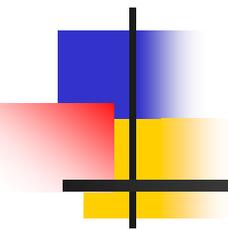


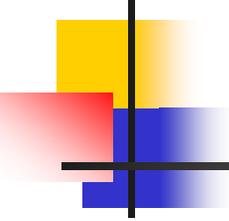
Financial Sector Development in Armenia: Problems and Challenges



Conference on "Armenia: Challenges of Sustainable Development" in honor of Professor of Armen Alchian.

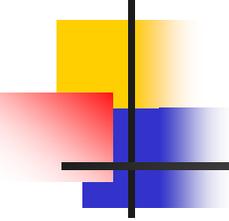
Nerses Yeritsyan, Central Bank of Armenia and AIPRG

May 6, 2006, UCLA



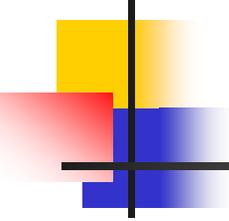
Content

- Where we stand
- Future Plans and challenges
- Expected Outcome of Reforms
- Lessons Learned



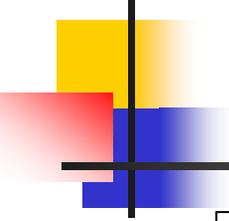
Where We Stand

- General overview of the financial structure
- History of reforms
 - Achievements
 - Shortcomings
- Opportunities



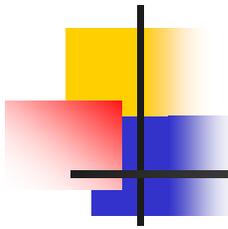
History of Reforms-Achievements

- Price stability has been maintained
- Capital account has been fully liberalized without side effects
- We have good financial system legislation and regulatory framework, which is in compliance with the best international practice
- We could built sufficient financial infrastructure, which is capable to meet current demand (real time electronic paym. and settl. system)
- Major and important consolidation in the banking system has been achieved. Banks mostly are sound and grow very fast
- Financial discipline prevails, as supervision and regulation is strong. Unified supervision provides new prospects
- Lessons are learned and a good strategy forward is in place (Vision of the CBA at www.cba.am)



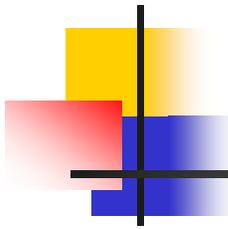
History of Reforms-Shortcomings

- There are capacity constraints both in public and private sectors
- Knowledge gap is large and the catch-up process in this regard is slow
- Investment capital inflows by foreign reputable investors has been limited, which could bring the culture of market economy and management, and also accelerate the learning process
- The financial structure developed disproportionately
- Consolidation process is not completed yet
- Banks and other financial institutions are short of capital to invest in new products and services, and thus competition is not sufficient
- Real Sector is not transparent and its savings are not yet available to the financial sector.
- Financial market players are satisfied (became complacent) and not interested in faster change



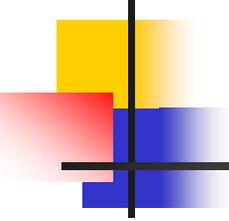
Shortcomings (continued)

Overcoming these shortcomings is a real challenge, but they also open new opportunities for the private sector and policy makers. Combined with global opportunities this may lead to a new policy framework that substantially and qualitatively change the pace of development in the financial sector and accelerate the catch up process with developed markets



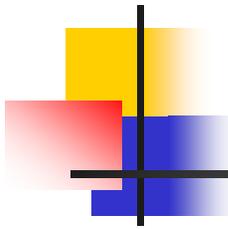
Opportunities

- Long standing price stability and double digit growths have improved household wealth value
- There is a large amount of private savings that have not been institutionalized and therefore could be brought into the financial sector (numbers)
- Aggressive global consolidation process, especially in the EU have raised the interest towards our region
- Large global liquidity is freed because of severe crises in emerging markets and are looking for new and more viable opportunities
- Real commitment by a couple of giant transnational financial players to partner with us in implementing our ambitious reform program,
- Surrounded with large neighbors that would never be institutionally strong.



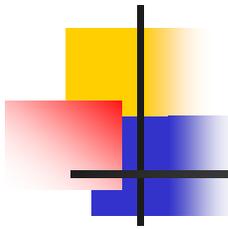
Future Plans and Challenges

- Changing attitude and behavior is necessary
- Right incentive structure and success stories might facilitate the process
- Reform endeavors in different sectors
- How the financial structure is expected to react to the reforms



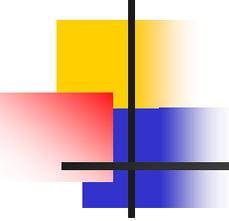
Banking Sector Reform

- Accelerating further consolidation by bringing a couple of reputable foreign banks
- Changing ownership structure of banks through implementing corporate governance principles
- Opening up the opportunities in other financial sectors, under unified supervision
- Moving towards risk based supervision and providing incentives to banks to become more responsible
- Encouraging investment into new technologies and products



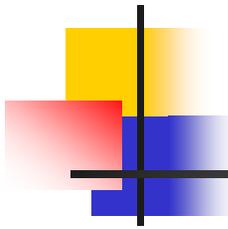
Insurance Sector Reform

- Will be fully foreign owned by “Blue Chips”
- Development of a business case is underway to approach them
- Domestic insurance companies will either consolidate faster than banks or closed down/ no tolerance as in case of banks, the best practice will not be compromised for them
- Mandatory insurance will be introduced with the entry of foreign insurance firms
- Pension reform will also encourage foreign entry
- As part of public policy efforts we will improve statistics and the claim registration systems. We will also back these insurance companies to have fare court response.



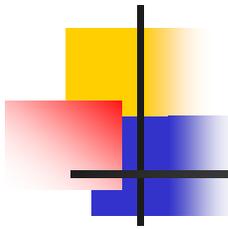
Capital Markets Reform

- Actively pursuing the regional capital market approach and will try to partner with a reputable European Stock Exchange (OMX)
- Current self regulatory structure will be changed and the stock exchange and central depository will be demutualised
- Focused capital market development will encourage the appearance of a couple of benchmark companies
- Different rating initiatives have been undertaken to facilitate the transparency process
- By demonstrating lost opportunities of not using well functioning capital markets, we will see moving from “family” ownership into corporate type of ownership



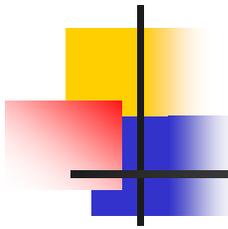
AML/CFT Regime

- Financial system's integrity is key to expected foreign direct investment
- FIU is located at the CBA, and became fully operational
- By good relation building with the reporting entities and law enforcement, Armenia would maintain its reputation of being remote from ML/TF



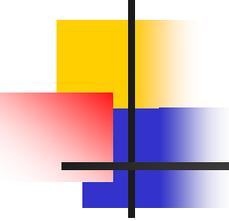
Other Reforms

- Government debt market will be growing faster with new opportunities
- Pension reform is a serious engine to the development of the financial sector
- Financial sector supervision will enhance its effectiveness



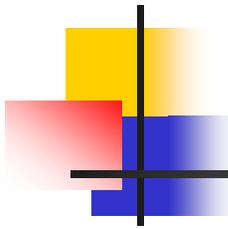
Expected Outcome of Reforms

- Price stability will be maintained
- Different sectors of the financial system will integrate and develop proportionately
- Armenian financial markets will be internationalized
- Business opportunities in the financial sector will become tangible for foreign reputable financial players



Lessons Learned

- Well designed outward policies are better way forward
- For a small open economy high quality foreign direct investment reduces knowledge gap faster and thus provides better access to FDI
- IT supported financial products, services and infrastructure should drive integration and internationalization
- Regional perspective should always be on the agenda despite the problems
- The speed of reforms is not as important, as implementing well thought , publicly debated and comprehensive (interms of design) reforms



Lessons Learned

- Different sectors of the financial system should be well integrated and cross sector risks well managed
- Better to put ambitious benchmarks, and achieve them gradually in a well sequenced way
- Financial contracts are the most sophisticated ones, and people may lose interest if reforms are implemented badly
- Long term benefits should be made countable to counteract short term costs of reforms
- Business conduct supervision is important to increase trust towards the financial sector
- Integrity of the system is a precondition for final success