

SUMMARY
of
CONDUCTING A STRATEGIC ANALYSIS OF MONEY LAUNDERING AND
TERRORISM FINANCING RISK IN THE REPUBLIC OF ARMENIA

1. Objectives and methodology of the strategic analysis

The main objectives of the strategic analysis of money laundering and terrorism financing (ML/TF) risk as summarized in this document are the following:

1. Clarify the possible sources, sectors, schemes and/or supporting circumstances that influence ML/TF offences and their suppression in the Republic of Armenia,
2. Enhance the direction and efficiency of AML/CFT mechanisms while readdressing them towards higher risk factors and sectors.

For these purposes, the Financial Monitoring Center of the Central Bank of the Republic of Armenia developed a methodology for conducting the strategic analysis which was approved on March 26, 2010 at the meeting of the Interagency Commission on the Fight against Counterfeiting of Money, Fraud in Plastic Cards and Other Payment Instruments, Money Laundering and Terrorism Financing. Basing on the methodology, the Interagency Commission also approved a decision to collect necessary data from authorized agencies and institutions during the following months (from 2009 statistics), analyze them and publicize the summary of results.

The analysis was conducted in seven directions as follows:

2. Predicate offences for ML/TF

In pursuance of clarifying the origins of proceeds for ML, statistics on predicate offences for ML, as specified under Article 190 of the Criminal Code of the RA, was analyzed, which provided for the evaluation of offences generating proceeds of crime in terms of their recurring involvement in possible ML schemes and the potential danger they pose. For this purpose, among all crimes recorded in 2009, the most material crimes against private property and offences generating proceeds of crime with at least 40 incidents recorded thereon were selected and taken into consideration for the conduction of the analyses.

Top 10¹ crimes that pose higher risk of ML in the Republic of Armenia are illustrated in the table presented below in the order of descending risk estimates:

Predicate offence	Number of crimes recorded with the current offence	a. Share of the current offence in the total number of crimes recorded ²	b. Share of crimes in large amounts in the total number of current offences	Risk estimate
- 1 -	- 2 -	- 3 -	- 4 -	- 5 -
Theft	3,961	0.60	0.15	0.090
Distribution of narcotics	539	0.09	0.70	0.063

¹ Data provided by the Police of the RA

² During 2009, total of 6,190 incidents were recorded with the offences presented in the table.

Fraud	738	0.12	0.20	0.024
Tax evasion	159	0.03	0.30	0.009
Banditry	151	0.02	0.40	0.008
Illegal and false entrepreneurship	79	0.01	0.70	0.007
Squandering or embezzlement	182	0.03	0.20	0.006
Contraband	72	0.01	0.60	0.006
Robbery	265	0.04	0.12	0.005
Bribery	44	0.01	0.30	0.002

Column 2 of the table illustrates the total number of crimes recorded during 2009 with the relevant offences.

The following indicators were calculated under Columns 3 and 4 in terms of each one of the offences:

- a. the number of crimes recorded with the current offence was divided by the total number of crimes recorded with all offences in order to evaluate the share of the current offence in the total figure,
- b. the number of crimes recorded in large amounts (3,000 thousand drams and more) with the current offence was divided by the total number of crimes recorded with the same offence in order to evaluate the share of large-amount crimes in the total figure.

Column 5 of the table illustrates the numerical values for risk estimates of the offences, which have been derived as a result of multiplying indicators a. and b. as to demonstrate the periodicity of recording the current type of offence that involves significantly large proceeds of crime. The above estimates lead to a conclusion that the following predicate offences pose higher risk of money laundering in the Republic of Armenia in terms of being possible origins of proceeds of crime: those are theft, distribution of narcotics and fraud. This is also evidenced by the thematic breakdown of court verdicts issued in 2009 that include the ML/FT component.

3. Legal System

Deficiencies or inconsistencies inherent to the legal system of the RA significantly contribute to the level of ML/FT risk and act as impairment for the effective enforcement of prevention and prosecution mechanisms against such crime. The most significant deficiencies and inconsistencies that were indicated in the third round evaluation report of the AML/CFT system of the Republic of Armenia (hereinafter: Evaluation report) as approved by the Council of Europe's MONEYVAL Committee, acted as a foundation for the analysis conducted with the above purposes. The deficiencies and inconsistencies were categorized by risks inherent to legal acts of preventive and criminal-legal frameworks, as well as risks associated with existent shortcomings in legal acts and the of implementation efficiency thereof. In terms of the above, the following risks are identified:

Risks inherent to legal acts of preventive framework

- Deficiency of mechanisms for law enforcement authorities to obtain bank secrecy information on legal persons,
- Possibility of issuing and servicing bearer instruments without any restriction on the value,
- Absence of fit and proprietary requirements for the ownership, management and beneficial owners of casinos, organizers games of chance and lotteries,
- Time-bound mechanisms for freezing of funds or other assets related to terrorism (absence of termless freezing mechanisms).

Deficiencies in effective enforcement of legal requirements of preventive framework

- Passive reporting on suspicious transactions by non-bank financial institutions and designated non-financial businesses and professions,
- Absence of adequate supervision and sanctions imposed by supervisory authorities on designated non-financial businesses and professions in terms of AML/CFT requirements,
- Relaxed supervision of ML/FT risks and absence of sanctions imposed on non-commercial organizations.

Risks inherent to legal acts of criminal-legal framework

- Absence of legal capacity to confiscate third parties' property in the scope of criminal cases with predicate offences.

Deficiencies in effective enforcement of legal requirements of criminal-legal framework

- Absence of autonomous ML/FT cases (without combination) examined,
- Relatively low number of cases and verdicts involving offences for ML compared to the number of cases and verdicts with predicate offences of higher risk.

4. Institutional systems

The evaluation of capacities of state authorized bodies and institutions that are addressed towards ML/FT prevention and criminal prosecution is of vital importance in terms of determining the ML/FT risk in the Republic of Armenia. For this purpose, the risk has been evaluated based on both the stipulations under the Evaluation report and the data from surveys conducted at relevant bodies and institutions as well as the deficiencies in enforcing the clarified legal requirements. At that, the systemic deficiencies and shortcomings evaluated are as follows:

In courts and law enforcement authorities of the RA (Court system, Prosecution Office, National Security Service, Police, State Revenue Committee)

- Lack of practical trainings for operative investigators, inquest officers, investigators and prosecutors in the field of tactics and methodology of examining ML/FT offences, collection and verification of evidence.

- Lack of practical trainings for prosecutors in the field of defending convictions of ML/FT in courts and those for prosecutors and judges in the field of characteristics of judicial proceedings for verifying and assessing evidence for cases of ML/FT.
- Lack of technical resources (computer equipment, connections, and special devices) for operative investigators, inquest officers and investigators.

In supervisory authorities of financial institutions (Financial Supervision Department of the Central Bank of the RA)

- Lack of professional capacities for scrutiny of AML/CFT related issues in the course of off-site surveillance and on site examinations at all types of financial institutions.

In supervisory authorities of designated non-financial businesses and professions (Ministry of Justice, Ministry of Finance, State Committee of Cadastre, Chamber of Advocates)

- Lack of professional resources for scrutiny of AML/CFT related issues in the course of supervision of non-financial institutions.
- Absence of supervision manuals (methodology) for each category of ML/FT risks inherent to the non-financial segments.

In the Financial Intelligence Unit (Financial Monitoring Center of the Central Bank of the RA)

- Need for upgrading the functions and processes of the Financial Monitoring Center based on the experience of other foreign financial intelligence in the field of systematizing processes.
- Presence of direct and efficient access problems to different sources of information.

5. Financial system

According to all estimates suggested by international practices, ML/FT risks of private sector are highly concentrated in the financial system considering the volume of financial assets flowing through this system, the variety of financial transactions and the ability of running transnational operations. The Republic of Armenia is not an exception from this rule where ML/FT risks and relevant schemes revealed are mainly practices in the financial sector as evidenced by the practices of the AML/CFT system in operation. The following features of different types of financial institutions were taken into consideration for the purpose of evaluating the ML/FT risk of the financial system of the Republic of Armenia: financial market share, type, quantity and average amount (in absolute value and as share in total) of transactions conducted/services provided, residency of ownership and clientele, periodicity of revealing ML/FT schemes of suspicious transactions, etc. Summary data³ on the distribution of assets between financial system participants is presented in Annex 1 attached, while Annex 2 illustrates certain characteristics⁴ of financial system participants' businesses that provide evidence for the low level of ML/FT risk inherent to the operations thereof.

³ "Financial system of Armenia; the development, regulation and supervision, 2009" periodic issue, Central Bank of the Republic of Armenia

⁴ Data provided by the Financial Supervision Department of the CBA

As a result of contrasting and analyzing the size of assets as a primary criterion, and other additional criteria (periodicity and volume of transactions, residency of ownership and clientele, STRs received, etc), the following volume-quantity concentration rates of assets and transactions in the financial system became apparent:

- For banks - 93-96%,
- For credit organizations, insurance companies, securities firms and money remitters - 3%-6%, and for other participants of the financial market (pawnshops, foreign exchange offices) - around 1%.

Considering the concentration rates above, as well as the fact that all participants of the financial system are supervised by a single body, that is the Central Bank, a conclusion can be drawn that the distribution of ML/FT risks and the preventive measures thereof are distributed among the segments of the financial system in the same proportion as that of the assets and additional criteria.

6. Non-financial sector

In comparison to other participants of the financial system, the risk level of designated non-financial business and professions involved in AML/CFT is significantly lower. The low level of risk is significantly evident in the Republic of Armenia due to the imperfect development of intermediated services in the non-financial sector, simple variety of services, limited turnover, foremost locally oriented nature of operations of institutions providing such services, lack of international relationships. Nevertheless, in relation to the assessment of ML/FT risk inherent to designated non-financial businesses and professions, the estimated financial turnover rates for separate segments and the possibility of involvement in suspicious ML/FT schemes were taken into consideration. At that, the following designated non-financial businesses and professions are considered of higher importance in terms of ML/FT risks:

According to 2009 statistics, total of 78⁵ entities organizing lotteries, games of chance and casinos were operating in Armenia, whereas the total sales revenue thereof in 2009 was 22,401,916 thousand RA drams⁶, i.e. 287,204 thousand RA drams annually in terms of each participant or in equivalence - 23,934 thousand RA drams of sales revenue per month. Considering the revenue rates above, as well as the fact that no transactions of financial nature are conducted within this segment, a conclusion can be drawn that ML/FT risks are considerably low herein.

This conclusion can be totally applicable to audit professionals also. Total of 31⁷ audit professionals were operating in 2009, whereby the total sales revenue thereof in 2009 was 4,411,970 thousand RA dram⁸, i.e. 142,322 thousand RA drams annually in terms of each participant or in equivalence - 11,860 thousand RA drams of sales revenue per month.

The largest segment of the non-financial sector is the real estate market (total of 15,199 real estate buying and selling transactions⁹ were conducted in 2009 amounting to 196,680,213 thousand RA drams) whereas transactions therein are conducted in intermediation of notaries. On the opposite side, the following circumstances lead to a conclusion that the real estate market is posed to a moderate level of ML/FT risk:

⁵ Data provided by Ministry of Finance of the RA

⁶ Net profit - 2,890,117 thousand RA drams

⁷ Data provided by the Ministry of Finance of the RA

⁸ Net profit - 499,731 thousand RA drams

⁹ Data provided by the State Committee of Real Estate Cadastre adjunct to the Government of the RA

- A unit of property with a value not exceeding 20,000 thousand RA drams was the subject of 85% of real estate buying and selling transactions conducted, whereas the underlying value of one transaction was 13,000 thousand RA dram on average,
- A significant portion of real estate buying and selling transactions is conducted in intermediation of realtors (total of 204 registered entities), whereas, total of 6 transactions amounting to 78,000 thousand RA drams are conducted by each realtor per month on average.

Statistical data on transactions conducted by attorneys, other legal professionals, sole practitioner accountants and accounting firms, dealers in precious metals and stones are not available; therefore risk analysis in these segments cannot be conducted.

Concurrently, the conducted analysis infers that there is no other segment in the non-financial sector of the Republic of Armenia or any institution (entity) involved therein that would pose a significant ML/FT risk.

7. Non-commercial segment

International practices suggest that non-commercial organizations (in particular for charities) are considered to pose higher risk due to their involvement in FT schemes. This risk is considerably lower in the Republic of Armenia due to the following circumstances:

- The population of Armenia is nearly-homogenous in terms of demographics, and no preconditions exist for causing severe conflicts on inter-ethnic or other grounds. This factor does not result in a favorable environment for terrorist organizations to operate and for the involvement of non-commercial organizations in such purposes.
- Around 84% (total of 5,890 organizations) of founders and ownership of non-commercial organizations are residents of the Republic of Armenia¹⁰, whereas the total number of branches and representations of foreign organizations is 708 which round to 12% of the total number, hence a lower probability for such organizations to be involved in international FT schemes.
- The objective of majority of charities is the assistance in meeting diverse social needs of Armenian residents, citizens or organizations, and not the collection and transfer of funds to other countries, which in turn provides for the low level of FT risks in this segment.
- The volume of financial and business operations of non-commercial organizations is considerably low (average financial turnover was 7,000 thousand RA drams per organization in 2009).

8. Economic, geographic and demographic environment

The structure of economy, geographic location of the country, demographic breakdown and other aggregate factors have a significant influence on the level of ML/FT risk in the country and explain the attractiveness and involvement of the country in ML/FT schemes. Thus, the following factors among the ones mentioned above are of importance for the Republic of Armenia.

¹⁰ Data provided by the Ministry of Justice of the RA

Considering the fact that one-third (1,111 thousand people)¹¹ of population (total number is 3,238 thousand people) of the Republic of Armenia resides in the capital city Yerevan, as well as the fact that 85% of trade turnover is conducted in Yerevan and the majority of financial institutions are headquartered herein, a conclusion can be drawn that, in geographic terms, ML/FT risks are concentrated in Yerevan.

Due to several estimations, the volume of shadow economy in the Republic of Armenia is around 25-30% of the GDP, which poses higher than average risk in terms of ML/FT. On the opposite side, cash in circulation is at 248,520,000 thousand RA drams on average¹², i.e. the volume of cash drams per resident of the RA is 76,000 thousand RA drams. Such volume of cash circulation (even after considering the rate of dollarization, which due to several estimations constitutes 40-70%) does not have a significant influence on ML/FT risk.

Non-commercial remittances received from abroad (mainly from diaspora) are of significant absolute value in the balance of payments of the Republic of Armenia, whereas the breakdown of originating countries is the following¹³: Russian Federation (80.4% of inflow), USA (5.3% of inflow), Ukraine (2.0% of inflow): Particularly, non-commercial remittances received from abroad by natural persons totalled to 1,124,119 thousand US dollars, outward remittances were 194,884 thousand US dollars, thus providing for net inflows of 929,235 thousand US dollars. Henceforth, on average, every resident of the Republic of Armenia receives 310 US dollars of remittances per year (25 US dollars per month). The findings presented lead to a conclusion that money received from abroad is used for consumer purposes mostly, thus no risk of ML/FT can present herein.

Foreign trade relations explain the presence of certain ML/FT risks inherent to import and export transactions. From this standpoint, ML/FT risks are concentrated in the following trade relations in terms of the breakdown of foreign trade turnover by countries (data on foreign trade turnover¹⁴): EU countries - 32%, Russian Federation - 20%, China - 9.5%, USA - 4.5%, Turkey - 4%, and the remaining 30% is distributed among other countries in small proportions (this risk is essentially effected by the efficiency of AML/CFT systems of given countries).

As mentioned above, the population of the Republic of Armenia is nearly-homogenous (Armenians - 97.9%, Yazidi Kurds - 1.3%, Russians - 0.5%), which does not contribute to the level of ML/FT risk in the country.

¹¹ Official website of the National Statistics Service (www.armstat.am)

¹² 2009 Statistics guidebook of the Central Bank of the RA

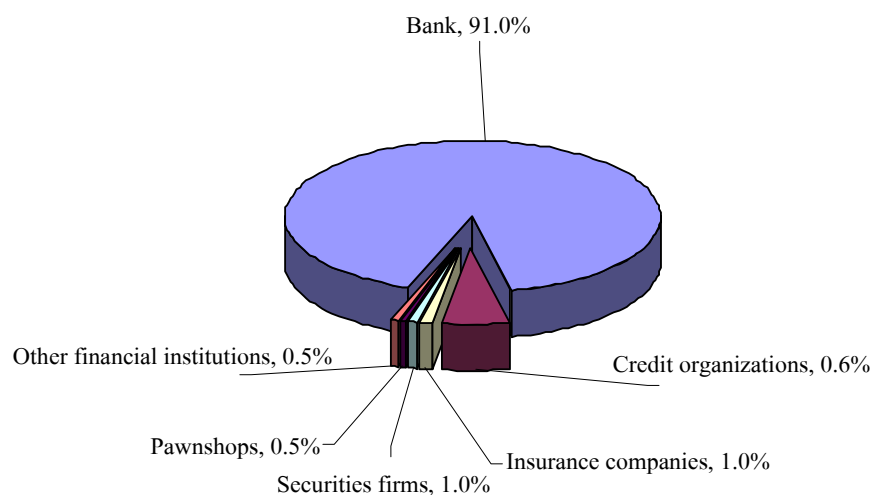
¹³ Data provided by the Statistics Department of the CBA

¹⁴ Official website of the National Statistics Service (www.armstat.am)

**Data on the distribution of assets among the participants of the financial system of the RA
(as of 30.06.2010)**

Total assets	thousand RA drams	thousand US dollars¹⁵	Share
Banks	1,329,239,000	3,616,977	91%
Credit organizations	86,347,000	234,958	6.0%
Insurance companies	17,239,000	46,909	1.0%
Securities firms	15,153,000	41,233	1.0%
Pawnshops	7,544,000	20,528	0.5%
Other financial institutions*	7,082,000	19,271	0.5%
Total	1,462,604,000	3,979,875	100.0%

* foreign exchange offices and money remmitters



¹⁵ The exchange rate as of 30.06.2010: USD 1 = AMD 367.5

Characteristics of credit organizations' operations (as of 30.06.2010)

Article	Indicator	Item
Total number of credit institutions*	29	unit
Total assets of credit organizations	86,347,000	thousand RA
Total amount of loans provided	49,831,000	thousand RA
Share of agricultural loans	24.0%	percentage
Share of business loans	21.0%	percentage
Share of mortgage loans	17.0%	percentage
Total number of loans provided	84,130	unit
Average amount of a loan provided	620	thousand RA

* Under the legislation of the RA, credit organizations are not granted a permission to collect deposits and provide payment services, and the main function thereof is the provision of loans

Characteristics of insurance companies' operations (as of 30.06.2010)

Article	Indicator	Item
Total number of insurance companies	10	unit
Total assets of insurance companies	17,239,000	thousand RA drams
Total number of insurance payouts in the first half of 2010	14,990	unit
Total amount of insurance payouts in the first half of 2010	783,647	thousand RA drams
Average amount of an insurance payout	52	thousand RA drams

* All insurance companies are exceptionally out of life insurance business

Characteristics of securities firms' operations (as of 30.06.2010)

Article	Indicator	Item
Total number of securities firms*	8	unit
Total assets of securities firms	15,153,000	thousand RA drams
Share of government bonds in the securities market	88.0%	percentage

* Securities firms other than banks

Characteristics of pawnshops' operations (as of 30.06.2010)

Article	Indicator	Item
Total number of pawnshops	117	unit
Total assets of pawnshops	7,554,000	thousand RA drams
Total amount of loans provided	7,374,000	thousand RA drams
Share of loans against gold	89.0%	percentage
Average number of loans provided a day	26	unit
Average amount of a loan provided	81	thousand RA drams

Characteristics of foreign exchange offices' operations (as of 30.06.2010)

Article	Indicator	Item
Total number of foreign exchange offices	302	unit
Total assets of foreign exchange offices	5,144,000	thousand RA drams
Average amount of a transaction	120	thousand RA drams

Characteristics of money remitters' operations (as of 30.06.2010)

Article	Indicator	Item
Total number of money remitters	10	unit
Total assets of money remitters	1,938,000	thousand RA drams
Average amount of a transaction	170	thousand RA drams