



REPUBLIC OF ARMENIA

FINANCIAL SECTOR ASSESSMENT PROGRAM

DETAILED ASSESSMENT OF OBSERVANCE—BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

This Detailed Assessment of Observance of the Basel Core Principles for Effective Banking Supervision on Republic of Armenia and was prepared by a staff team of the International Monetary Fund and World Bank. It is based on the information available at the time it was completed in November 2018.

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November 2018

DETAILED ASSESSMENT OF OBSERVANCE

BASEL CORE PRINCIPLES FOR EFFECTIVE BANKING SUPERVISION

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GLOSSARY

AML/CFT	Anti-Money Laundering/Counter Financing of Terrorism
AMD	Armenian Drams
BCBS	Basel Committee on Banking Supervision
BCPs	Basel Core Principles
CBA	Central Bank of Armenia
CET 1	Common Equity Tier 1
CMC	Crisis Management Committee
CMG	Crisis Management Guide
CSD	Central Securities Depositories
CPs	Core Principles
DTI	Debt-To-Income Ratio
DGF	Deposit Guarantee Fund
FMC	Financial Monitoring Center
FMI	Financial Market Infrastructure
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSD	Financial Supervision Department
FSN	Financial Safety Net
FSSDD	Financial System Stability and Development Department
FSSRC	Financial Stability and Special Regulation Committee
FX	Foreign Exchange
HQLA	High Quality Liquid Assets
ICAAP	Internal Capital Adequacy Assessment Process
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IRR	Interest Rate Risk
LBB	Law on Banking and Banking Activities
LCB	Law on the Central Bank of the Republic of Armenia
LCR	Liquidity Coverage Ratio
LOLR	Lender of Last Resort
LTV	Loan-To-Value
ML/TF	Money Laundering/Terrorist Financing

MOF	Ministry of Finance
MoU	Memorandum of Understanding
NPLs	Non-Performing Loans
NSFR	Net Stable Funding Ratio
PCA	Prompt Corrective Action
PEP	Politically Exposed Person
QRM	Quantitative Risk Management
RTGS	Real Time Gross Settlement
RBS	Risk Based Supervision
ROE	Return on Equity
ROSC	Report on Observance of Standards and Codes
SME	Small to Medium Size Enterprises
SRR	Special Bank Resolution Regime
STR	Suspicious Transaction Report
TTR	Threshold Transaction Report
UBO	Ultimate Beneficial Owner

INTRODUCTION¹

1. The Central Bank of Armenia (CBA) has made significant progress in its approach to banking supervision with adoption of the RBS framework and addressing gaps in the regulatory framework identified in the 2012 Basel Core Principles (BCP) assessment. The recently adopted RBS framework provides a forward-looking assessment of the risk profile of individual banks and groups and assigns supervisory resources more proportionate to the risk in the system, and to the risks within individual banks. The use of risk teams to take ownership of individual risk across the banking system also contributes to identification and monitoring of risks emanating from banks and the banking system as a whole. In addition, improvements have been made in the regulatory regime regarding requirements for risk management, stress testing, corporate governance, country risk and consolidated supervision.

2. The CBA has largely complied with the recommendations from the 2012 FSAP. CBA has addressed the requirement for banks to report material adverse changes in their operations, introduced certain Pillar 2 techniques via the risk-based supervision program, and passed legislation enabling consolidated supervision. AML/CFT regulations have also been improved. The liquidity coverage ratio for foreign currency has been introduced only for monitoring purposes pending resolution of the shortage of HQLA in foreign currency.

INSTITUTIONAL AND MARKET STRUCTURE—OVERVIEW

3. Armenia's financial system has expanded further since the 2012 FSAP but remains dominated by banks. The banking sector's assets have risen from 58 percent of GDP in 2012 to 78 percent in 2017, and branch and ATM penetration have also grown rapidly. Higher capital requirements announced in 2014 and implemented in 2017 have led to the merger/acquisition of four banks since 2015. The non-bank sector is still small but growing. The insurance sector more than doubled after third-party auto insurance became mandatory in 2010, but since 2013, its assets have remained broadly constant at about 1 percent of GDP; nonlife insurance premia collected are low by international comparison, and there are no life insurance services. The reform of the pension system launched in 2011, and expected to come into full force in 2018, has introduced a defined-contribution scheme based on funds run by private management companies under public supervision. At present, there are six such funds, with assets equivalent to 1.9 percent of GDP.

Table 1a. Armenia: Financial System Structure

	2012				2017			
	Assets, billions of drams	Share of GDP, percent	Share of Total System's Assets	Number of Institutions	Assets, billions of drams	Share of GDP, percent	Share of Total System's Assets	Number of Institutions
Banks	2470.6	57.9	90.1	22	4364.4	78.2	85.5	17
Credit Organizations	168.5	4.0	6.1	32	474.8	8.5	9.3	35
Insurance Companies	38.4	0.9	1.4	7	49.5	0.9	1.0	7
Investment Companies	23.6	0.6	0.9	9	64.3	1.2	1.3	9
Mandatory Pension Funds*	105.7	1.9	2.1	6
Other Financial Organizations*	42.3	1.0	1.5	150	44.0	0.8	0.9	139
Total	2743.4	64.3	100.0	220	5102.7	91.4	100.0	209

Source: Central Bank of Armenia.

*Includes payment companies and pawnshops.

*Includes net assets.

¹ This Detailed Assessment Report has been prepared by Jack Jennings, IMF and Philippe Aguera, World Bank.

Table 1b. Armenia: Financial System Structure

	2012		2017	
	Outstanding Amounts, billions of drams	Share of GDP, percent	Outstanding Amounts, billions of drams	Share of GDP, percent
Government bonds	249.4	5.8	546.6	9.8
Corporate bonds	9.1	0.2	92.2	1.7
Shares	52.9	1.2	57.7	1.0

Source: Central Bank of Armenia.

4. The domestic securities market is growing rapidly from a low base but remains shallow. Although the value of securities issued in the primary market has been almost constant in percent of GDP since 2012, market capitalization and the value of secondary market transactions have doubled. Still, issues in the primary market are dominated by government bonds and by three commercial banks, and almost all repo and reverse repo transactions in the secondary market involve government bonds. Key financial market infrastructure includes two electronic payments systems and a credit information system.

5. Banks are relatively small and have significant external links. About half of banking assets are of subsidiaries of foreign banks; while nonresidents account for about 25 percent of deposits and 14 percent of loans.

6. The interbank market is small but not insignificant for some banks. As of December 2017, interbank transactions in AMD represented 8 percent of banks' funding. In general, participants are well connected with each other although a few banks play a larger role making them more systemically important.

7. At present, the banking sector appears well capitalized, but profitability and credit quality have not yet fully recovered. At end-2017, capital adequacy ratio

was about 19 percent (with 15.7 percent leverage) and all banks have achieved the new CBA-mandated minimum capital (AMD 30 billion, equivalent to \$62 million)² which came into effect in January 2017. Coupled with a pickup in credit growth, bank profitability has recovered but remains low. Two of the five largest banks have ROE below the cost of capital. The NPL ratio has fallen to around 6 percent of total loans (reflecting, inter alia, lending growth and write-offs prior to some M&A deals in 2016–17),

Table 2. Armenia: Bank Size and Ownership

Bank	Share of Assets, percent	Domicile of Majority Shareholder
1 Ameria	15.5	Cyprus
2 Armbusiness	13.2	Armenia
3 Ardshinbank	13.0	Armenia
4 ACBA-Credit Agricole	7.1	Armenia
5 InecoBank	6.4	Armenia
6 Converse	5.8	USA
7 VTB Armenia	5.0	Russia
8 Ararat	4.9	Armenia
9 HSBC Armenia	4.8	UK
10 Unibank	4.7	Cyprus
11 Armeconom	4.4	Armenia
12 ArmSwiss	3.7	Luxembourg
13 Artsakh	3.1	Armenia
14 ID Bank (formerly Anelik)	3.0	Cyprus
15 Evoca	2.4	Russia
16 Byblos	2.0	Lebanon
17 Mellat	1.1	Iran

Source: KPMG, Armenian Banking Sector Overview 2017Q4.

² The exchange rate as of 29/12/2017 was 484 AMD per 1 USD.

of which about 50 percent are covered by provisions. NPL ratios are still high in some banks at above 10 percent and mainly relate to the trade, construction and industry segments, together representing 30 percent of loans.

A. Microprudential Oversight

8. Although the supervisory regime has recently transitioned from a rules-based to a risk-based program (RBS), there is a need for continued refinement of the program for more granular assessments of firms' capital needs. The process for conducting risk assessments of each firm has identified a need for building a stronger and more structured (system-wide) understanding of the level and magnitude of risk and the risk management capabilities across banking firms. Supervisory activities should continue to be prioritized for larger, more complex firms to complete these assessments on a timely basis. With regard to such activities, there should be a better balance between the conduct of on-site validation activities and off-site financial analysis. Stress testing and ICAAP processes conducted by banks are important elements of the RBS program for risk management; however, standardized criteria for their review and evaluation should be developed. The overall programs need enhancement in several areas to meet Pillar 2 principals for supervisory review and intervention triggers.

9. Supervisory resources of the CBA to conduct a risk-based supervision program should be re-evaluated annually. Though there is currently no apparent shortage in the staffing of FSD, the CBA should annually conduct a resource planning exercise. The number of staff has not changed in five years, with a core group of individuals staffing both institutional supervision and risk teams. The RBS program has clearly raised expectations with regard to the analytical skill sets of the staff. It is noted that the FSD has reached out to other departments within the CBA for assistance, notably the FSSDD for stress testing and business plan reviews, and information technology for cyber reviews. This type of resource sharing provides assistance in meeting resource demands and builds strong relationships among the departments and is encouraged; however, it does not substitute for an adequately trained core group of supervisors. CBA should be commended for developing a specialized training vision and program for supervisors. In addition to providing training to existing staff, consideration should be given to also hiring individuals with previous experience/training in risk analytics, stress testing, and risk management as those needs are identified.

10. Broaden disclosure of thematic work regarding risks and risk management practices across the system. The FSD risk teams are conducting thematic work across groups of banks to identify where risk levels may be rising, or new risks may be emerging. The reviews are also taking stock of bank practices for identifying, managing and mitigating risks. The results of some of these reviews have been shared with the banking sector (e.g., operation risk survey, role of risk management function). The CBA is encouraged to continue providing insights to the industry and the public regarding their evaluation of risk in the system and better practices available to manage risks that are identified through these reviews.

11. The definitions of nonperforming and restructured loans need to be amended to reflect international best practices. Currently, the CBA uses a non-standard and quite conservative definition

of non-performing loans (day 1 of delinquency) and has a definition of restructured loans that is not well supported by examples or detailed supervisory explanations. Also, the CBA does not provide detailed guidance on evaluating performance periods for restoring restructured loans to performing status, and instead assesses the adequacy of banks' internal regulations, where these periods are established, on a case by case basis. The CBA should more closely align its definitions for nonperforming and forbore (restructured) loans with the BCBS guidance issued in April 2017 regarding "Prudential treatment of problem assets—definitions of non-performing exposures and forbearance." The guidance is intended to harmonize the scope, recognition criteria, and level of application of both terms, thereby promoting a better understanding of the terms, improving identification and monitoring, and promoting consistency in the supervisory reporting and disclosures by banks.

12. The CBA assessment of credit risk management should incorporate a review of IFRS 9 expected loss estimation practices required for all banks in 2018. As banks are adapting to the new IFRS 9 expected loss methodologies, they will be basing more of their credit risk management activities regarding measuring, monitoring and reporting risk on IFRS 9 techniques. Supervisors will need to enhance their review and understanding of IFRS 9 methodologies if they are to make accurate assessments of a bank's credit risk management capabilities. Also, the CBA should consider whether greater convergence between supervisory reporting and IFRS would result in a clearer, more accurate assessment of credit risk management practices, provisions, reserves and capital adequacy.

13. The CBA should adopt Basel III LCR and NSFR approaches for liquidity. Current methods for establishing prudential standards based on liquid assets as a percentage of both total assets and demand liabilities, as well as FX prudential limits for these ratios should be replaced, or at least complemented by the LCR and NSFR. The LCR in particular has a more granular approach to stressed outflows that is preferable.

14. The CBA needs to develop a non-discretionary regime of supervisory actions in response to a bank's deteriorating capital or liquidity position. Such responses may include submission of remediation plans, ceasing dividends and discretionary compensation, and limits on growth, types of activities, or funding sources. Although the CBA has the authority to use these supervisory limits at its discretion, a clearer framework for banks outlining the use of these limits incrementally, would assist banks in pro-actively managing their activities to avoid these consequences, and ensure a level of consistency and transparency in the application of these measures.

15. The use of discretionary enforcement powers to address risk management concerns has not been consistent nor always effective. There has been a pattern since 2016 where banks have breached large exposure limits regularly. Although sanctions/fines have been levied in some cases, these have apparently not been sufficient to prevent further violations. The CBA should review its enforcement tactics with regard to large exposure limits with an aim towards having banks operate within the limits consistently.

16. Home/host communications should be broadened to encompass resolution strategies and enterprise-wide risk management issues. No Armenian banks operate cross-border; however, the CBA is a host supervisor for several local subsidiaries of foreign banks. There are instances where banks are adopting risk management and control systems within the parent for their Armenian subsidiaries. Furthermore, foreign bank subsidiaries are large and meaningful in the local market. The CBA should discuss resolution plans for large firms with home supervisors to determine what, if any, steps should be taken to ensure resolvability of their local subsidiaries. MoUs should be amended where feasible to ensure there are no obstacles to sharing information either for ongoing supervisory purposes or, in particular, regarding resolution strategies.

B. Financial Integrity

17. While improvements have been made since the 2015 AML/CFT assessment, key deficiencies remain to be addressed. Armenia has taken steps to address some of its deficiencies, notably by revising some sections of its AML/CFT national risks assessment, introducing a risk-based approach to AML/CFT supervision, and amending the AML/CFT law to clarify requirements for targeted financial sanctions in relation to proliferation financing. While these efforts are welcomed, further steps should be taken to deepen the understanding of risks and disseminate findings to the private sector and continue to improve risk-based supervision. In addition, measures to detect the laundering of proceeds of corruption should be strengthened, by enacting and implementing the specific enhanced due diligence requirements for domestic politically-exposed persons as called for by the AML/CFT standard, and by ensuring that financial institutions and other obliged entities report related suspicious transactions.

PRECONDITIONS FOR EFFECTIVE BANKING SUPERVISION

18. Effective supervision is dependent on having the necessary preconditions in place. These include: (i) sound and sustainable macroeconomic policies; (ii) a framework for financial stability including policy formulation, mechanisms for inter-agency coordination, resolution and safety-nets; (iii) a well-developed public infrastructure including a system of business laws, the accounting, auditing and legal professions, judiciary and clearing, payment and settlement systems; and (iv) transparency and market discipline.

19. Armenia's economic recovery has firmed up on the back of stronger growth and rising inflation. A decline in the price of copper (Armenia's main export product) and the weakening of the Russian economy in 2014 had taken a toll on the Armenian economy. After two to three years of low growth, a revival in domestic demand, supported by rising remittances and monetary easing allowed growth to pick up strongly in 2017 (7.5 percent) and in early 2018. Annual CPI inflation, which had been in the negative territory from late 2015 to early 2017, reached 2.4 percent in April 2018, approaching the CBA's medium-term inflation target (4 percent). Driven by faster recovery in imports, the current account deficit widened to 2.8 percent of GDP in 2017.

20. Looking ahead, decisive policies are needed to both reduce vulnerabilities and enhance growth inclusiveness. While economic growth has been robust and prospects for medium-term growth have improved, as a dollarized small open economy, Armenia remains susceptible to external shocks. Fiscal adjustment has been delayed by external shocks, which has led to a sharp increase in public debt. In addition, barriers to domestic competition and a weak business environment have limited the development of a vibrant private sector. Against the backdrop of the numerous challenges, fiscal policies, guided by the newly adopted fiscal rule, envisage a prudent medium-term fiscal path to lower public debt. Monetary policy continues to aim at maintaining price stability, while financial sector policies intend to further modernize the sector. The new government pledged to fight against corruption and improve competition as its main policy priorities. The next step is to develop specific concrete measures to achieve the objectives of the program.

21. CBA staff have embarked on very good crisis preparedness planning; however, there is room for improvement. At the CBA, there is an active unit—the Financial Stability and Special Regulation Committee (FSSRC) that is tasked with financial stability monitoring, special regulation, crisis preparedness and management issues. Although the FSSRC has made great strides within CBA, other Financial Safety Network members are not represented on the committee except by invitation. The authorities should create a high-level Crisis Management Committee (CMC) comprised of the Minister of Finance, CBA’s Governor, and the head of the DGF. Information from the FSSRC regarding crisis preparedness and management issues should be up streamed to the CMC. The CMC and FSSRC should continue the evolution of their crisis preparedness and management regime by continuing and refining simulations to produce practical crisis management procedures, manuals and checklists.

22. The capacity for the CBA to engage in lender of last resort support for solvent but illiquid banks (LOLR) is granted pursuant to Article 38 of the LCB and is mostly based on the traditional Bagehot formula—to provide financial assistance to illiquid, but solvent banks, on good collateral, and at above-market rates (see below). CBA may provide loans to banks with a maturity not exceeding six months, and in exceptional cases, for one year. Collateral listed in Article 38.2 represents high quality collateral; however, in extenuating circumstances CBA may accept other collateral or provide unsecured loans. The LCB establishes “varied interest rates” for LOLR facilities, which implies that the CBA could impose higher or lower than market rates. LOLR should carry punitive interest rates (higher than market) and unsecured loans should not be extended unless necessary in crisis situations.

23. The CBA is the resolution authority empowered, as appropriate, to revoke a bank’s license. Currently, however, Armenia’s Law on Bank Bankruptcy provides for a cumbersome, time-consuming and more costly court-based bank resolution and liquidation. Article 3.2 permits CBA, and only CBA (Article 25), to file a bank bankruptcy claim for insolvent banks with the Court. This framework presents bank owners with several days warning (5 days under Article 27.2 and 3 days under Article 29.1), of pending liquidation, a period in which, if CBA supervisors are not on-site monitoring transactions and granted authorization to block transactions (especially insider and related party), insiders have a golden opportunity for asset-stripping. Moreover, Article 28.2 indicates that the Court considering bank bankruptcy cases may only apply liquidation procedures, seemingly blocking a more efficacious P&A resolution transaction. Most troubling is the fact that if the Court rejects the CBA’s application to put the bank into bankruptcy, the CBA is required to re-establish the banking

license of the bank within 10 days. If this were to occur, the CBA would have to return the bank to the owners in the same condition it was in when seized. This means that there could be no transactions and depositors would not have access to their funds for up to 18 days (5 + 3 + 10), causing financial distress for customers and risking contagion and deposit runs at other stronger banks. An effective legal framework would place bank resolution and liquidation as administrative functions under the CBA, which would limit losses and maximize recoveries. Amendments to the LBB and Law on Bank Bankruptcy must include a special bank resolution regime (SRR), which, at a minimum, should provide that the supervisory authority's decision to revoke a bank's license cannot be reversed; thus, enabling the supervisory authority to take swift resolution action to make clients' insured deposits available promptly.

24. Armenia's Deposit Guarantee Fund (DGF) has the standard deposit insurance objectives to protect small depositors and contribute to financial stability. It is a very narrow "paybox" mandate, which means that it can only use its funds to reimburse insured depositors in the event of a bank failure. It cannot contribute funds to facilitate any other type of resolution, including the most effective P&A transaction. The DGF Law provides that two members of the management board be representatives of the Banking Union. A subsequent MOU among DGF, CBA and MOF eliminates this provision which represents a potential conflict of interest. There are really no deposit insurance cross-border issues, as DGF covers all foreign bank subsidiaries in Armenia and no foreign deposit insurer covers deposits in the foreign bank subsidiaries in Armenia. DGF's scope of coverage includes only individuals and sole proprietorships. In line with best practices, insider and related party deposits, are excluded from coverage. Armenia's DGF has a two-tiered coverage level, covering 10 million AMD in local currency, and the equivalent of 5 million AMD in foreign currency deposits.

25. Armenia is finalizing the design of a new public oversight framework for accounting and auditing. It aims at strengthening the quality control over audit firms and fostering improved accounting and auditing market practices and hence increase reliability and trust in corporate financial information. The draft legal package of amendments to Accounting and Auditing Legislation, which include creation of a Public Oversight Board and Chamber of Accountants and Auditors, is currently being reviewed by the Government and is expected to be submitted to Parliament and enacted before end 2018.

26. The corporate governance framework in Armenia is comprised by the Law on Joint Stock Companies, the Law on Banks and Banking Activity, the Law on Securities Market and a Corporate Governance Code adopted in 2010. The Legislation allows joint stock companies to have a one-tier board structure and Chief Executive Officers (CEO) can serve as chairman of the boards. In many corporate cases (excluding financial institutions), board functions remain poorly defined. The Governance Code suggests that boards and audit committees have at least two independent members, but only three listed companies complied with this requirement in 2017. Only banks and other regulated financial institutions have fit & proper requirements for board members. Banks and corporations are required to report in line with IFRS (all listed companies complied with the requirement in 2017), while banks also report to CBA under the statutory regulatory requirements. All the joint stock companies are required to have an external audit for annual financial statements and public disclosure of annual reports on their websites (9 out of 10 listed companies complied with this

in 2017). While the Corporate Governance Code recommends having an independent audit committee and an internal audit function, only a handful of corporates but all the banks do so. Corporate Governance Code provides for disclosure of information on related parties transactions, however absence of independent directors and internal audit in the corporate sector hinders compliance with this requirement. EBRD 2017 Corporate Governance Assessment report provides detailed overview of Armenia's compliance with OECD Corporate Governance Principles and WBG ROSC Methodology, and issues recommendations for enhancement.

27. The Armenian Financial Market Infrastructure (FMI), is comprised of the sole Electronic Payment System (EPS) and two Central Security Depositories (CSD)—one for government (owned and operated by the CBA) and one for corporate securities segments (owned and operated by the private sector). The Electronic Payment System owned and operated by the CBA operates on the real-time gross settlement basis, which eliminates settlement risk to the system's participants. Banks are entitled to fully use their reserve requirements to settle payment obligations; in addition, collateralized intraday repo is made available to participants to mitigate liquidity risks for the participants and the system, with the CBA minimizing credit risk to itself by taking high quality collateral with haircuts while providing intraday liquidity support. Management of operational risks is based on sound principles and redundancy of network and server infrastructure. Similarly, delivery-versus-payment mechanisms are used for settling both Government and Corporate securities segments. The planned introduction of new IT systems for the central bank's general ledger and the RTGS will present an opportunity to further improve participants' liquidity management, while the formal adoption of the Principles for Financial Market Infrastructures (PFMI) will contribute to a stronger and more systematic FMI oversight.

28. Armenia significantly strengthened its regime governing secured transactions and creditor's and debtor's rights, by adopting a new law on secured transactions that established a modern and centralized collateral registry. The new secured transactions' regime has been a clear step in the direction of best practice standards. While many of the secured transactions law provisions comply with good practices, additional improvements are necessary to include types of security interests that are not addressed by the new regime; to improve the functionality of the collateral registry; and to strengthen creditor's rights in the event of default, with the aim of reducing the costs and time in assets foreclosure and hence improve loss recovery rate for lenders. The bankruptcy regime was also improved in the last years, most recently in 2016, and includes many elements of a well-functioning insolvency framework. It requires further improvement to strengthen the balance of creditor and debtor rights, in order to support the efficient reallocation of resources across the economy and increase the chances of rehabilitation of viable companies. However, implementation remains a challenge and institutional reforms (related to judges and insolvency administrators) should be further addressed.

29. Armenia has a comprehensive and well-functioning credit reporting system comprised of a private credit bureau and the Central Bank of Armenia's credit registry. Armenia's credit bureau, ACRA Credit Reporting Closed Joint Stock Company, was established in 2004 and is jointly owned by the CBA (40.1 percent) and banks, with a minor equity stake of D&B. ACRA is collecting data from all 17 banks, as well as credit organizations, insurance companies, and three telecoms operators. As of April 2018, ACRA's database contained information on 15.8 million loans from 1.6 million subjects

(corporates and individuals). The database covers 81.3 percent of the labor population in Armenia. The credit reports contain 5 years of information (from the inquiry date) about the payment behavior of various financial obligations of physical/legal entities, including data on the proper fulfillment and/or delinquencies of financial obligations. Any person (individuals and organizations) can apply for its own credit report from ACRA office or from the member organization of ACRA if the person is applying for a loan or is going to enter into another legitimate business transaction. In 2014 the World Bank under DPO2 has agreed with CBA to (i) support development of a private credit bureau and reform CBA credit registry to stop selling credit information to the market and focus the work of the credit registry towards the needs of CBA only; (ii) support reform of the private credit bureau by encouraging divestment of CBA stake (40.1 percent) to private ownership, and allowing credit bureau to access information from other registries (to include utilities payments data, other relevant information for a more comprehensive overview of borrowers' debts); (iii) strengthen CBA oversight of credit bureau and enhance consumer protection for the users/borrowers (including in access to data, accuracy, data protection). CBA has taken measures to strengthen credit reporting oversight and terminate the sale of private credit information data to external users. The WB Doing Business Report (DBR) 2017 gave Armenia a score of 8 out of 8 points on the Depth of Credit Information Index. As of May 2017, 78.3 percent of adults were covered by the private credit bureau, compared to an average of 42.8 percent in the region. In the light of the recent changes in personal data protection requirements in EU it needs to be clarified what additional measures Armenia may need to take in the area of consumer data and rights protection.

MAIN FINDINGS

Responsibilities, Powers, Independence, Resources, Accountability and Cooperation (Principles 1–3)

30. The CBA's supervisory responsibilities and powers are well established. Accountability could be improved through public reporting of performance of the supervision function relative to its specific objectives. Further, MOUs with foreign supervisors should be revisited to address resolution strategies for large banks.

Ownership, Licensing and Structure (Principles 4–7)

31. Armenia has a generally high level of compliance with these principles, with appropriate legal requirements and review processes in place. Current laws and regulations cover all the key elements of an effective licensing framework and the approach to assessing the fitness and propriety of major shareholders and senior management of an applicant bank is appropriate. During the interview process, CROs and Heads of the compliance functions are not yet included, but CBA has prepared a draft amendment to be able to do so.

Methods of Ongoing Supervision (Principles 8–10)

32. The CBA has made a significant improvement in its approach to banking supervision with adoption of the Risk-Based Supervision framework. The Risk-Based Supervision Framework (RBS) formally adopted in 2017 is designed to provide a more forward-looking assessment of risks and their impact on capital and liquidity; enable supervisory planning to focus resources more proportionately

on emerging risks and on firms with more systemic impact; integrate a macroeconomic perspective into supervisory assessments, and strengthen the CBAs understanding of risk management practices. Of particular note is the institution of risk teams in the Supervision Department and focus on conducting thematic inspections and reviews by the latter, which aids better systemic view and risk-based resource allocation. The program is still in its first full cycle of implementation, and while it has identified knowledge gaps to be closed, initial results are promising. Supervisory activities planned for 2018 based on the risk assessment results appear more balanced between off-site analysis and on-site validation activities. Supervisory reporting for off-site analysis and monitoring is a strong point of the CBA regime. In addition to standard financial reports, CBA has access to transactional information on borrowers through a credit registry and a database of all bank internal policies.

33. The CBA is to be commended for implementing this RBS and is encouraged to further enhance its supervisory approach. Areas for further development in supervisory approaches relate to the need for a non-discretionary framework for dealing with weak banks (PCA) and assessing resolvability in larger firms.

Corrective and Sanctioning Powers (Principle 11)

34. The CBA has a wide range of corrective and sanctioning powers, and while there is evidence that they have been effective, there were observed weaknesses in taking enforcement action to address a pattern of large exposure breaches. There were observed inconsistencies in the application of sanctions for all large exposure breaches. The CBA should review its enforcement practices with regard to large exposure limits with an aim towards consistently applying sanctions and having banks operate within prescribed limits. Further, the CBA should consider designing and implementing a Prompt Corrective Action regime to guide decision-making in dealing with banks under stress. The CBA has yet to implement a requirement that larger banks have recovery plans, or to initiate resolution planning in line with the best practices documented in the Financial Stability Board Key Attributes of Effective Resolution Regimes for Financial Institutions.

Consolidated and Cross-Border Supervision (Principles 12, 13)

35. Laws and regulations were enacted to identify affiliated entities as “financial groups” and subject them to consolidated supervision. The regulations give CBA discretion to distinguish its supervisory approaches among complex/not low-risk groups and low-risk groups. All groups are required to file consolidated returns and reports on inter-group transactions, while not low-risk groups are also subject to prudential standards on a consolidated basis. Low-risk groups are supervised on a solo basis, as currently there are no complex/not low-risk groups.

36. No Armenian banks currently have foreign operations. Subsidiaries of four foreign banks operate locally. Supervisors attend supervisory colleges for two of these foreign banks. For foreign owned large banks, the CBA should contact home supervisors to gain an understanding of their recovery/resolution frameworks. MOUs should be updated as necessary to accommodate sharing of resolution related information.

Corporate Governance Prudential Requirements, Regulatory Framework, Accounting and Disclosure (Principles 14–29)

37. The Corporate Governance regulations for banks are generally adequate; and significant supervisory work has been conducted in this area, in particular with regard to the review of bank strategic planning and role of the risk management function in banks. However, there is a need for more work on the part of supervisors to understand and validate governance practices across firms.

The CBA's prudential standards and supervisory review of specific risks are generally sound.

- Capital adequacy requirements are based on Basel II definitions and risk-weightings, while the quality requirements for elements included in regulatory capital are consistent with the Basel III requirements,
- There have been significant changes in laws and regulations that provide flexibility for the CBA to require good risk management systems in banks. Regulations require banks to have the essential elements for comprehensively identifying and managing risk, including stress testing capabilities and ICAAP processes. Supervisory work to validate risk management systems and fill knowledge gaps is ongoing.
- Credit risk is monitored closely via on-site reviews and off-site access to borrower information in the credit registry. Unhedged FX borrowers represent significant risk in the loan portfolio and enhancements to credit risk management requirements (e.g., more stringent and targeted DTIs and LTVs) are suggested. Steps were taken recently to provide banks with a common supervisory definition of the risk from unhedged FX borrowers for monitoring purposes.
- Problem assets are also monitored closely via monthly classification reports and activity observed in the credit registry. The CBA has historically maintained a conservative philosophy with regard to provisioning and charge-offs. Definitions of NPLs and restructured loans are not aligned with BCBS guidance from 2017; it is recommended that these new definitions be adopted to provide investors and other supervisors with data that is comparable with other jurisdictions.
- The CBA began LCR and NSFR monitoring in 2015 and is intending to adopt these measures pending resolution of a policy matter regarding FX reserve requirements that has resulted in a misbalance between AMD and FX HQLA. The CBA is reviewing options to address this issue and intends to adopt the Basel III standards once this obstacle is addressed
- The CBAs regulations provide that only audit firms with broad based experience are eligible to audit banks. IFRS is the accounting standard. Disclosure practices are considered adequate based on IFRS and CBA requirements. Supervisors are in close contact with both internal and external auditors.
- Measures to detect the laundering of proceeds of corruption should be strengthened. Domestic politically-exposed persons should be defined in the legal framework and subject to AML/CFT requirements.

DETAILED ASSESSMENT

A. Information and Methodology Used for Assessment

37. This assessment was conducted against the standard issued by the Basel Committee on Banking Supervision (BCBS) in 2012. Since the past BCP assessment, which was carried out in 2012 against the 2006 version of Core Principles, the BCP standards have been revised. The revised Core Principles (CPs) strengthen the requirements for supervisors, the approaches to supervision, and the supervisors' expectations of banks through a greater focus on effective risk-based supervision and the need for early intervention and timely supervisory actions. Furthermore, the 2012 revision placed increased emphasis on corporate governance and supervisors' conducting sufficient reviews to determine compliance with regulatory requirements and thoroughly understanding the risk profile of banks and the banking system. This assessment was thus performed according to a significantly revised content and methodological basis compared to the previous BCP assessment.

38. The Armenian authorities opted to be assessed against both essential criteria (EC) and the additional criteria (AC) but graded on the basis of EC only. To assess compliance, the BCP Methodology uses a set of EC and AC for each principle. The EC set out minimum baseline requirements for sound supervisory practices. The AC are recommended as the best practices against which the authorities of some more complex financial systems may agree to be assessed and graded. Armenian authorities chose to be graded against the EC only.

39. Grading is not an exact science and the CPs can be met in different ways. The assessment of compliance with each principle is made on a qualitative basis. Compliance with some criteria may be more critical for effectiveness of supervision, depending on the situation and circumstances in a given jurisdiction. Emphasis should be placed on the commentary that accompanies each Principle grading, rather than on the grading itself.

40. The assessors held extensive meetings with CBA staff, commercial banks and other relevant counterparts who shared their views with the assessors. The team also reviewed the framework of laws, regulations, and supervisory guidelines. The CBA provided a self-assessment of the CPs and answered comprehensively to preparatory questionnaires. The assessment team appreciated the excellent cooperation and would like to thank the CBA staff for their preparation and responsiveness during the assessment period.

B. Supervisory Powers, Responsibilities and Functions

Principle 1	Responsibilities, objectives and powers. An effective system of banking supervision has clear responsibilities and objectives for each authority involved in the supervision of banks and banking groups.³ A suitable legal framework for banking supervision is in place to provide each responsible authority with the necessary legal powers to authorize banks, conduct ongoing supervision, address compliance with laws and undertake timely corrective actions to address safety and soundness concerns.⁴
Essential criteria	
EC1	The responsibilities and objectives of each of the authorities involved in banking supervision ⁵ are clearly defined in legislation and publicly disclosed. Where more than one authority is responsible for supervising the banking system, a credible and publicly available framework is in place to avoid regulatory and supervisory gaps.
Description and findings re EC1	<p>The Central Bank of Armenia (CBA) is the sole regulatory and supervisory authority for the whole financial system of Armenia. It is responsible not only for the banking system, but also for non-bank financial institutions, such as non-bank credit organizations, insurance companies, investment companies, investment fund managers, payment-settlement organizations, etc.</p> <p>Based on the new Article 200 of the recent Constitution (2015), the CBA mandate has been amended (April 2018) to add financial stability as one of the dual primary objectives of the Central Bank along with ensuring price stability. This is a major change from the previous situation in that “if other objectives conflict with its primary objectives, the Central Bank shall give the priority to its primary objectives and be guided by the necessity to implement them” (LCB, art 4.3). The CBA Law (November 2015) and new Constitution have established the position of a second deputy chairman of CBA.</p>
EC2	The primary objective of banking supervision is to promote the safety and soundness of banks and the banking system. If the banking supervisor is assigned broader responsibilities, these are subordinate to the primary objective and do not conflict with it.
Description and findings re EC2	The responsibilities and objectives of CBA as the banking supervisor are defined and disclosed mainly in the Law “On the Central Bank of the Republic of Armenia” (hereinafter referred to as LCB), as amended in April 2018. In addition to stating that ensuring financial stability is one of the two primary objectives of the CBA, Article 5(1)(a) of the LCB as amended states that one of the Central Bank objectives is “to provide necessary conditions for stability, liquidity, solvency and regular activities of the financial system of the Republic of Armenia.” Articles 20 and 36 of LCB states that CBA is authorized to issue “the prudential standards regulating to the activities of the banks and calculation thereof” (art.20, ji), including the legally binding prudential regulations, including “possible loss provisioning

³ In this document, “banking group” includes the holding company, the bank and its offices, subsidiaries, affiliates and joint ventures, both domestic and foreign. Risks from other entities in the wider group, for example nonbank (including non-financial) entities, may also be relevant. This group-wide approach to supervision goes beyond accounting consolidation.

⁴ The activities of authorizing banks, ongoing supervision and corrective actions are elaborated in the subsequent Principles.

⁵ Such authority is called “the supervisor” throughout this paper, except where the longer form “the banking supervisor” has been necessary for clarification.

	<p>and capital calculation” (art.36.1). Also, according to Article 5, e) of the LCB, the CBA is also responsible for regulation of AML/CFT.</p> <p>There is a lack of clarity in the segregation of duties regarding banking supervision between the two deputy chairmen. According to internal procedures reviewed by the assessors, both are in charge of “banking and credit organizations activity, configuration, and development”, while the first deputy chairman is also in charge of monetary policy.</p>
EC3	Laws and regulations provide a framework for the supervisor to set and enforce minimum prudential standards for banks and banking groups. The supervisor has the power to increase the prudential requirements for individual banks and banking groups based on their risk profile ⁶ and systemic importance. ⁷
Description and findings re EC3	<p>Article 57 of the LBB gives the CBA the exclusive rights to supervise banks and “the Central Bank shall implement that supervision as determined in Chapter 5 of the LCB”.</p> <p>The LCB and the LBB (Law on Banks and Banking, dated 1996 as amended) are supported by a body of prudential Regulations issued by the Central Bank which have statutory backing and provide a framework of minimum prudential standards that banks and banking groups must meet. The primary sources of legislation governing the regulation and supervision of banking are laws, including Laws on the Central Bank (LCB), on Banks and Banking Activities (LBB), Law on Bank Secrecy (1996), Law on Guaranteeing Compensation of Bank Deposits (2004). LBB was amended in April 2018, which gives the CBA i) more flexibility to establish detailed prudential standards for banks, and ii) power to establish new standards which the CBA was not allowed to do before (buffers, leverage, outsourcing, as examples).</p> <p>Secondary sources of the legislation governing regulation and supervision of the banking sector are Central Bank Board resolutions that shall derive from the primary source and implement in details requirements applied to the banks, including prudential regulation of banks, registration and licensing requirements, consumer protection and market conduct regulation.</p> <p>Main current prudential regulations, resolutions and orders are the following:</p> <ul style="list-style-type: none"> • Regulation 1 on Registration and Licensing of Banks and Branches of Foreign Banks, Registration of Bank Branches and Representative offices, qualification and registration of managers of banks and branches of foreign banks; • Regulation 2 on “Regulation of banking, prudential standards for banking;” • Regulation 3 on Bank Reports, the Submission and Publication Thereof; • Regulation 4 “Minimum requirements for implementation of internal control of banks;” • Regulation 8/01 on Explanations and Examples of the Calculation of Annual Percentage Rate of Charge; • Regulation 8/02 on the Calculation of Annual Percentage Yield of Bank Deposits; • Regulation 8/03 on Information Publication by Banks, Credit Organizations, Insurance Companies, Insurance Brokers, Investment Companies, Central Depository and Payment and Settlement Organizations Implementing Money Remittances;

⁶ In this document, “risk profile” refers to the nature and scale of the risk exposures undertaken by a bank.

⁷ In this document, “systemic importance” is determined by the size, interconnectedness, substitutability, global or cross-jurisdictional activity (if any), and complexity of the bank, as set out in the BCBS paper on Global systemically important banks: assessment methodology and the additional loss absorbency requirement, November 2011.

- Regulation 8/04 on Minimum Conditions and Principles for Internal Rules, Regulating the Procedure of Examination of Complaints/Claims of Customers;
- Regulation 8/05 on the Procedure, Terms, Forms and the Minimum Requirements for Communication Between Bank and Depositor, Creditor and Consumer;
- Regulation 9 on Operations with Cash in Banks Functioning on the Territory of the Republic of Armenia;
- Resolution 39-N on Approval of the Procedure of Election of Independent Audit Company by Banks Operating in the Republic of Armenia;
- Regulation 20 on "Preliminary consent on self-liquidation, documentation and information for acquisition of authorization for self-liquidation, qualification requirements for liquidation committee, head and members of temporary administration, liquidator and mortgage managers, forms, procedures, terms and periodicity of reports subject to submission to the Central Bank by liquidation committee, head of temporary administration, liquidator and mortgage manager, list and order of publication by liquidation committee, head of temporary administration, liquidator and mortgage manager of information;"
- Regulation 20/01 "Rules on Recognition of financial groups and Termination of financial group qualification, Introduction of changes in the financial group composition, Appointment procedures of responsible entities, Types of financial groups;"
- Regulation 20/02 "On Thresholds of prudential standards for financial groups, Calculation methodology, Elements included in calculation and Schedule of calculation";
- Regulation 20/03 "On Reports submitted by financial groups to the Central Bank of the Republic of Armenia and Terms of their submission";
- Regulation 20/04 on Minimum requirements on internal control for financial groups;
- "Minimal Requirements for Implementation of Internal Control in Banks";
- Resolution 25-N on the Procedure of Opening and Maintenance of Unallocated Metal Accounts;
- Resolution 63 on Approval of Procedure on Classification of Loans and Receivables and Creation of Possible Loss Reserves for Banks Operating in the Territory of the Republic of Armenia;
- Resolution 114-N on Approval of Guideline on Acquisition of Qualified or Other Holding in Bank or Holding Position of Manager of a Bank, Acquisition of Qualified Holding in Insurance Company or Holding Position of Manager in Insurance Company or Responsible Official of Insurance Brokerage Company, Acquisition of Qualified Holding in Investment Company, Regulated Market Operator, Central Depository or Holding Position of Manager;
- Resolution 205-N on Instructions for Completing Financial Reporting Forms Published ;
- Resolution 385-N on Approval of Regulation on "Presentation of Prospective development programs to the Central Bank of the Republic of Armenia by the banks operating in the Republic of Armenia", "Form of Prospective Development programs of banks operating in the Republic of Armenia;"

According to Article 44(4) of the LBB, "the CBA may set tighter prudential standards for a separate bank than for other banks, if supervisory grade of the bank is below the threshold set by the Central Bank, or the financial indicators of the bank have deteriorated, or the bank executed high risk activities," or the bank is considered as a systemically important bank (amendment LBB Dec. 2017). In practice, until the Risk Based Supervision (RBS) approach was implemented, the FSD was using the CAMELS supervisory rating system for the banks, to assess their situation regarding the threshold set by the Central Bank.

EC4	Banking laws, regulations and prudential standards are updated as necessary to ensure that they remain effective and relevant to changing industry and regulatory practices. These are subject to public consultation, as appropriate.																										
Description and findings re EC4	<p>Laws and regulations are regularly updated. The CBA plays a central role in the initiation and preparation of new laws. The CBA also introduces regulations as the need arises considering the new standards set by international regulatory bodies and national specifics, subject to a public consultation process. In practice, initiation of new regulations is triggered in three ways—following international regulatory and best practices developments, after emerging needs appeared during on-site and off-site supervision, or at the request of the industry.</p> <p>It should be noted that at least six amendments to LBB and LCB have been recently introduced, since October 2017:</p> <p><i>Law on Banks and Banking (LBB)</i></p> <table border="1" data-bbox="402 636 1281 961"> <thead> <tr> <th>Amendment date</th> <th>Document number</th> </tr> </thead> <tbody> <tr> <td>17.12.2014</td> <td>268-N</td> </tr> <tr> <td>12.11.2015</td> <td>134-N</td> </tr> <tr> <td>21.12.2015</td> <td>16-N</td> </tr> <tr> <td>27.10.2016</td> <td>194-N</td> </tr> <tr> <td>25.10.2017</td> <td>188-N</td> </tr> </tbody> </table> <p><i>Law on Central Bank of Armenia (LCB)</i></p> <table border="1" data-bbox="402 1026 1281 1404"> <thead> <tr> <th>Amendment date</th> <th>Document number</th> </tr> </thead> <tbody> <tr> <td>12.11.2015</td> <td>133-N</td> </tr> <tr> <td>21.12.2017</td> <td>282-N</td> </tr> <tr> <td>13.12.2017</td> <td>313-N</td> </tr> <tr> <td>21.03.2018</td> <td>197-N</td> </tr> <tr> <td>23.03.2018</td> <td>247-N</td> </tr> <tr> <td>23.03.2018</td> <td>258-N</td> </tr> </tbody> </table> <p>All drafts are discussed with the industry (banks and the Banking Association of Armenia) before being presented to the Board of the Central Bank. As assessors have been able to verify, CBA takes into account, when relevant, the industry comments and proposals.</p>	Amendment date	Document number	17.12.2014	268-N	12.11.2015	134-N	21.12.2015	16-N	27.10.2016	194-N	25.10.2017	188-N	Amendment date	Document number	12.11.2015	133-N	21.12.2017	282-N	13.12.2017	313-N	21.03.2018	197-N	23.03.2018	247-N	23.03.2018	258-N
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EC5	<p>The supervisor has the power to:</p> <ul style="list-style-type: none"> (a) have full access to banks' and banking groups' Boards, management, staff and records in order to review compliance with internal rules and limits as well as external laws and regulations; (b) review the overall activities of a banking group, both domestic and cross-border; and (c) supervise the activities of foreign banks incorporated in its jurisdiction. 																										
Description and findings re EC5	(a) Articles 39(3) and 39(4) of the LCB specify that the supervisor has full access to a supervised entity's staff, including members of the Board, and records even if they contain any banking, commercial or other secrets in order to review compliance with regulation. Article 57 of the LBB requires all banks to accept and assist CBA staff in the																										

	<p>carrying out of their regulatory function. It prohibits the banks from hindering or hampering or in any other way interfering with the supervisors.</p> <p>(b) Chapter 5.2 of LCB defines the power of CBA to do consolidated supervision (see CP 12).</p> <p>(c) CBA regulates and supervises all banks registered in Armenia, including the local activities of foreign banks. Under Art. 39.1 of the LCB, the supervisors shall carry out inspections in all banks, including foreign bank branches if any. According to Art. 28 of the LBB, all banks require the permission of the CBA to establish foreign branches and subsidiaries.</p>
EC6	<p>When, in a supervisor's judgement, a bank is not complying with laws or regulations, or it is or is likely to be engaging in unsafe or unsound practices or actions that have the potential to jeopardize the bank or the banking system, the supervisor has the power to:</p> <p>(a) take (and/or require a bank to take) timely corrective action;</p> <p>(b) impose a range of sanctions;</p> <p>(c) revoke the bank's license; and</p> <p>(d) cooperate and collaborate with relevant authorities to achieve an orderly resolution of the bank, including triggering resolution where appropriate.</p>
Description and findings re EC 6	<p>Article 39.7 of the LCB empowers the CBA to take sanctions against banks and their management where a violation of "the requirements of laws regulating their activity and other normative regulation" have taken place. Several corrective actions are detailed in Articles 35, 41, 36, 57, 58 of LBB, including Art. 44 which allows CBA to apply higher prudential standards. Article 60 of LBB provides that these sanctions can also be applied where, inter alia, "in the opinion of the CBA, the bank has undertaken activities that can endanger the interests of the depositors or other creditors of the bank, or the bank has not implemented the orders given by the CBA". Article 61 of the LBB specifies the sanctions applicable to banks. They include warnings and directives to eliminate infringements, fines on bank and bank managers, deprivation of a bank manager's qualification certificate, and nullification of the license. As for the resolution process, the Bank of Armenia is the sole regulatory and supervisory authority for the whole financial system of Armenia (see EC1) and in case of emergency situation, all issues related to the financial crisis management process are discussed by the Financial Stability and Special Regulatory Commission (FSSRC).</p>
EC7	<p>The supervisor has the power to review the activities of parent companies and of companies affiliated with parent companies to determine their impact on the safety and soundness of the bank and the banking group.</p>
Description and findings re EC7	<p>Article 39.15 of the LCB defines the financial group as a group of affiliated two or more financial organizations and their parent company. Chapter 18 of Regulation 1 specifies the list of information to be submitted regularly by the banks to the Central Bank. Additionally, the transactions between financial organizations and their parent companies are intragroup transactions to be reported to CBA. Transactions with non-financial affiliates are considered intergroup as well. According to Point 17 of Regulation 20/03, CBA has the authority to require submission of other reports or other information about the financial group (or subgroup) or the institutions involved in the group.</p> <p>To mitigate the risks emerging from the parent company or the other companies involved in the group, the Central Bank may set a large range of prudential standards for the financial group or the individual sub-group of the financial group. The CBA defines the reports and information that the financial group should publish on its official web page.</p>
Assessment of Principle 1	Compliant

Comments	<p>The banking supervisory responsibilities and objectives of the CBA are clearly enshrined in legislation. The legal and regulatory framework for banking supervision provides the CBA, as the “mega regulator,” with the necessary powers to license banks, set prudential regulations and to take action against banks in the event of breaches in compliance with laws and to promote safety and soundness issues.</p> <p>There is no evidence to suggest that the dual mandates of financial stability and price stability are compromising the setting of prudential standards. However, safeguards are needed to counter the risks from dual objectives. The CBA considers that firewalls are already in place by organizing the functions separately under two deputy Chairmen, one in charge of the Monetary Policy Committee and the other responsible for the Financial Stability Committee. This could further be facilitated by assigning specific policy tools to the committees and improving communication strategies. Also, more clarity regarding bank supervision duties of the deputy Chairmen would be helpful.</p>
Principle 2	<p>Independence, accountability, resourcing and legal protection for supervisors. The supervisor possesses operational independence, transparent processes, sound governance, budgetary processes that do not undermine autonomy and adequate resources; and is accountable for the discharge of its duties and use of its resources. The legal framework for banking supervision includes legal protection for the supervisor.</p>
Essential criteria	
EC1	<p>The operational independence, accountability and governance of the supervisor are prescribed in legislation and publicly disclosed. There is no government or industry interference that compromises the operational independence of the supervisor. The supervisor has full discretion to take any supervisory actions or decisions on banks and banking groups under its supervision.</p>
Description and findings re EC1	<p>The independence of the CBA is enshrined in the Constitution of Armenia (Article 200). Article 1(4) to 1 (6) of the LCB specify that the CBA, as a supervisory authority, is independent from state authorities in the implementation of its mandate. Article 13 of the LCB states that the CBA is independent in its budget planning.</p> <p>The LCB defines the organizational and management structure of the CBA, the rights and responsibilities of the CBA Board as well as the Chairman and Deputy Chairman. The Board of the Central Bank is composed of the Chairperson, two deputies and five members.</p>
EC2	<p>The process for the appointment and removal of the head(s) of the supervisory authority and members of its governing body is transparent. The head(s) of the supervisory authority is (are) appointed for a minimum term and is removed from office during his/her term only for reasons specified in law or if (s)he is not physically or mentally capable of carrying out the role or has been found guilty of misconduct. The reason(s) for removal is publicly disclosed.</p>
Description and findings re EC2	<p>The Board members are elected by the National Assembly (by the majority of the total National Assembly votes, and at least 3/5 of total National Assembly votes for the Chairman) for a term of six years and for no more than two consecutive terms for the Chairman.</p> <p>Article 22 of the LCB specifies the reasons for which the Chairman and other Board members may be removed from office by the National Assembly (again by the majority of the total National Assembly votes, and at least 3/5 of total National Assembly votes for the Chairman) these reasons include recognized disable or conviction by Court of an intentionally committed criminal offence, professional misconduct, or deprivation of the right to hold certain positions.</p>

	In the last two decades, no governor has been removed before the end of his term. However, there is no statutory requirement in the LCB that the reasons for removal of the governor or a Board member be publicly disclosed. However, the CBA asserts that according to Constitutional Law of the RA and internal Rules of procedure of Parliament, the removal is subject to discussion at the plenary session of the Parliament. The Plenary sessions are public.
EC3	The supervisor publishes its objectives and is accountable through a transparent framework for the discharge of its duties in relation to those objectives. ⁸
Description and findings re EC3	The CBA's objectives are defined by Article 200 of the Constitution of the RA and Articles 4 and 5 of the LCB. These include ensuring stability of prices, financial stability, ensuring stability and normal activity of the financial system, issuing currency, licensing and supervising banks, combatting money laundering, etc. The CBA publishes an annual report on "The Banking System of Armenia: Development; Regulation; Supervision" and bi-annual reports on financial stability. However, it is recommended that the CBA enhance its disclosure of specific supervisory objectives and the outcomes of activities designed to meet those objectives. The Central Bank shall submit to the National Assembly an annual communication on its activities (art 200.6 of the Constitution, art 17.4 of the LCB).
EC4	The supervisor has effective internal governance and communication processes that enable supervisory decisions to be taken at a level appropriate to the significance of the issue and timely decisions to be taken in the case of an emergency. The governing body is structured to avoid any real or perceived conflicts of interest.
Description and findings re EC4	Decisions within the CBA are made by the Governor or the Board. The Governor, for example, makes decision on annual inspections in banks (based on consultation with Board members), while prudential regulations are approved by the Board. Board meetings are divided into two sessions: the open sessions do not discuss bank specific issues (i.e., matters relating to confidential regulatory matters) whereas closed sessions do. Meetings are held regularly, but in case of necessity and/or emergency situations, extraordinary meetings also can be held. The government representative who is not a member of the Board attends the open sessions but not the closed sessions. Since 2000, attending the open sessions of the Board is subject to the confidentiality requirements which apply to board and staff members of the CBA. The representative signs the obligation not to disclose any information received during the Board meetings. Under the existing framework, a banking license is issued or repealed by a decision of the Central Bank Board whereas sanctions, including penalties, are imposed on banks by the decision of the Governor of the Central Bank. To ensure the objectivity of the decision process, a Licensing and Supervisory Committee operates as an advisory body to the Governor. The Licensing and Supervisory Committee consists of the Governor (Head), one of the Vice-Governors (Deputy Head), Head and Deputy of Financial Supervision Department, Heads of Legal, Financial System Stability and Development, and Financial System Regulation Departments. as well as the Head of Consumer Rights Protection and Financial Literacy Center. In case of an emergency situation, all the main issues related to the financial crisis management process would be discussed by the FSSRC. In the case of a systemic crisis, proposed actions by the FSSRC have to be submitted for the approval of the Board of CBA.
EC5	The supervisor and its staff have credibility based on their professionalism and integrity. There are rules on how to avoid conflicts of interest and on the appropriate use of information obtained through work, with sanctions in place if these are not followed.

⁸ Please refer to Principle 1, Essential Criterion 1.

Description and findings re EC5	<p>The CBA has issued a Code of Ethics, which all staff are required to comply with. This sets out the standards the CBA expects of its staff, including with respect to the use of confidential information and its policy on conflicts of interest. All supervisors are obliged to disclose their potential conflicts of interest and update the information on an annual basis, thus minimizing the risk and cases of conflicts of interests when performing their duties. Article 28 of the LCB defines, that “the Chairman, the Deputies, the other Board members and the staff of the Central Bank neither may make public or otherwise disseminate information, containing official secrets, nor may use such information for personal gain”. Articles 24 (limitation of employees of the Central Bank external activities) and 27 (conflicts of interest) complete the framework. The assessors found the staff at all levels to be knowledgeable of the banking supervisory framework and very professional, and private sector interlocutors confirmed the professionalism of CBA staff.</p>																														
EC6	<p>The supervisor has adequate resources for the conduct of effective supervision and oversight. It is financed in a manner that does not undermine its autonomy or operational independence. This includes:</p> <ul style="list-style-type: none"> (a) a budget that provides for staff in sufficient numbers and with skills commensurate with the risk profile and systemic importance of the banks and banking groups supervised; (b) salary scales that allow it to attract and retain qualified staff; (c) the ability to commission external experts with the necessary professional skills and independence, and subject to necessary confidentiality restrictions to conduct supervisory tasks; (d) a budget and program for the regular training of staff; (e) a technology budget sufficient to equip its staff with the tools needed to supervise the banking industry and assess individual banks and banking groups; and (f) a travel budget that allows appropriate on-site work, effective cross-border cooperation and participation in domestic and international meetings of significant relevance (e.g., supervisory colleges). 																														
Description and findings re EC6	<p>Staffing of the banking supervision related units has been stable during the last five years, while the number of banks decreased from 22 to 17.</p> <table border="1" data-bbox="402 1192 1221 1402"> <thead> <tr> <th></th> <th>Licensing</th> <th>Regulation</th> <th>Supervision</th> <th>IT</th> </tr> </thead> <tbody> <tr> <td>2013</td> <td>15</td> <td>5</td> <td>35</td> <td>5</td> </tr> <tr> <td>2014</td> <td>16</td> <td>9</td> <td>32</td> <td>5</td> </tr> <tr> <td>2015</td> <td>15</td> <td>9</td> <td>32</td> <td>5</td> </tr> <tr> <td>2016</td> <td>18</td> <td>9</td> <td>34</td> <td>5</td> </tr> <tr> <td>2017</td> <td>17</td> <td>8</td> <td>35</td> <td>5</td> </tr> </tbody> </table> <p>Under Article 13 of the LCB, the CBA is independent in the preparation of its budgets. According to art. 14 of LCB, the Board of the Central Bank shall “approve, before September 15 of each year, the capital investments program and the budget of expenditures of the Central Bank for the next year. However, the budgets of administrative expenses and the ceiling of the capital investments of the Central Bank shall be approved by the National Assembly of the Republic of Armenia under a separate article in the National Budget Law.”</p> <p>The authorized representative of the Government may participate in open sessions of the Board of the Central Bank with the right to an advisory vote and submit a written opinion on the matters discussed (LCB, art. 7(4)). The government representative is subject to the confidentiality requirements of the Central Bank and shall sign a commitment not to disclose the information, received during the Board meetings.</p> <p>According to CBA, there are no indications that this process in any way impedes the necessary development and growth of the supervisory functions. The Government cannot issue operational instructions to the CBA. According CBA Law, art. 1(5) the Central Bank</p>		Licensing	Regulation	Supervision	IT	2013	15	5	35	5	2014	16	9	32	5	2015	15	9	32	5	2016	18	9	34	5	2017	17	8	35	5
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	<p>shall be independent from the state bodies of the Republic of Armenia in the implementation of its goals, objectives, powers and functions vested therein by Constitution and Law.</p> <p>Salary scales are pitched at those that exist in the banking system as a whole to encourage people to enter and remain with the CBA. The compensation plan is competitive enough. No longer than once every three years, the CBA conducts a survey comparing CBA employees' salaries with commercial/private banks' salaries, to ensure that according to LCB, salaries of CBA employees correspond to the industry average. As a matter of fact, turnover is very low with the few supervisors leaving the CBA having been recruited by financial sector organizations.</p> <p>CBA's training and education policy is very structured in order to offer development opportunities to staff members. To facilitate the change process in FSD, a targeted training program (vision) was developed in 2017 jointly by the FSD and HR department. Training is organized by making use of both in and out of the country resources, including cooperation with other Central banks. Training objectives are defined based on each employee's professional needs. They cover both technical and soft skills. In the last five years, trainings have been aimed at risk-based supervision, communication and interviewing skills. CBA encourages getting international professional qualification certificates such as ACCA, CIA, CFA, ISACA certificates and there are some job positions for which getting professional certificate is obligatory. For supervisors and regulators, FSI Connect online tutorials are mandatory too. After completing the tutorials employees are obliged to undergo an interview with special assessment committee to demonstrate that they truly possess the required knowledge and skills.</p> <p>Supervisors are trained abroad on a regular basis and have participated in on-site inspections in The Netherlands for example. CBA takes part on a regular basis to Supervisory colleges organized by home countries.</p>
EC7	As part of their annual resource planning exercise, supervisors regularly take stock of existing skills and projected requirements over the short- and medium-term, taking into account relevant emerging supervisory practices. Supervisors review and implement measures to bridge any gaps in numbers and/or skill-sets identified.
Description and findings re EC7	The Central Bank has a very flexible recruitment system. As a general rule, the CBA recruits' new employees twice a year, after the candidates pass a two-month training program at the CBA's training center. When recruiting the staff, usually young professionals, the Central Bank takes into consideration the work program of the next year, its mid-term and long-term objectives, as well as the potential gaps in the number and qualification of the existing staff. In addition, in case of necessity, the Central Bank may recruit high-qualified staff from other financial and non-financial organizations.
EC8	In determining supervisory programs and allocating resources, supervisors take into account the risk profile and systemic importance of individual banks and banking groups, and the different mitigation approaches available.
Description and findings re EC8	Recently the CBA has implemented risk-based supervision (RBS). Hence, the supervisory resources are allocated based on the riskiness and systemic importance of the supervised entities. There are three divisions in the Financial Supervision Department (FSD), which are responsible for both on-site and off-site supervision of banks (see CP8). Banks are distributed randomly to the divisions and rotated frequently. Each bank is assigned to at least two to three supervisors: one being the core supervisor and the rest are supporting supervisors. Five specialized risk teams were established in 2016: Credit risk (5 supervisors), Market and Liquidity risk (3 supervisors), Operational risk (2 supervisors), Corporate Governance (2 supervisors) and Compliance risk (2 supervisors). These teams are responsible for on-site and off-site supervision and monitoring per respective risk across the banking sector. They work in close cooperation with bank supervisors assisting

	<p>supervisors with risk identification and assessments and ensuring that the timing of bank inspections is based on the perceived risks.</p> <p>Also, the latest amendments in the LCB (December of 2015) authorize the CBA to implement consolidated supervision over financial groups. According to Regulation 20/01 CBA classifies financial groups based on their risk profile. Supervisory processes are different for groups in different risk categories (see CP 12).</p>
EC9	Laws provide protection to the supervisor and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. The supervisor and its staff adequately protected against the costs of defending their actions and/or omissions made while discharging their duties in good faith.
Description and findings re EC9	A recent amendment to the LCB (December 2017) provides legal protection to the CBA and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith. According to Article 24(5) of LCB, the Central Bank, its management bodies, staff and any other person acting on behalf of the Central Bank shall not be liable for (including compensation for damages) decisions with regard to supervision, for any action or omission if acted in good faith.
Assessment of Principle 2	Compliant
Comments	<p>The requirement that the reasons for the dismissal of the Governor or the Board be publicly disclosed is met through provisions set out in a number of documents, such as the Constitution of the Republic of Armenia and the Law of Internal Procedures of the National Assembly. It is advised that the CBA Law be revised so that the statutory requirements that the reasons for removal of the Governor or a Board member be publicly disclosed are contained in the CBA Law itself.</p> <p>The CBA publishes an annual report on “The Banking System of Armenia: Development; Regulation; Supervision” and bi-annual reports on financial stability. However, it is recommended that the CBA enhance its disclosure of specific supervisory objectives and the outcomes of activities designed to meet those objectives.</p> <p>Though there is currently no apparent shortage in the staffing of FSD, the assessors recommend that the CBA completes its resource planning exercises: the number of staff has not changed in five years, with a core group staffing both institutional supervision and risk teams. The RBS program (see EC 8) has clearly raised expectations with regard to the analytical skill sets of the staff. It is noted that the FSD has reached out to other departments within the CBA for assistance, notably the FSSDD for stress testing and business plan reviews, and Information Technology for cyber reviews. This type of resource sharing provides assistance in meeting resource demands and builds strong relationships among the departments and is encouraged; but it does not substitute for an adequately trained core group of supervisors. CBA should be commended to have developed a specialized training vision and program for supervisors to implement this training requirement. Two supervisors from FSD have been devoted to take care of this program and two supervisors were sent to De Nederlandsche Bank for on-the-job training. This practice should continue in the coming years.</p> <p>In addition to providing training to existing staff, as additional staffing needs are identified consideration should be given to hiring individuals with previous experience/training in risk analytics, stress testing, and risk management.</p> <p>A recent amendment to the LCB (December 2017) provides legal protection, including on related costs, to the CBA and its staff against lawsuits for actions taken and/or omissions made while discharging their duties in good faith.</p>

Principle 3	Cooperation and collaboration. Laws, regulations or other arrangements provide a framework for cooperation and collaboration with relevant domestic authorities and foreign supervisors. These arrangements reflect the need to protect confidential information.
Essential criteria	
EC1	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with all domestic authorities with responsibility for the safety and soundness of banks, other financial institutions and/or the stability of the financial system. There is evidence that these arrangements work in practice, where necessary.
Description and findings re EC1	<p>The CBA is the sole regulator and supervisor of the financial system in Armenia. The CBA has established The Financial Stability and Special Regulatory Committee (FSSRC), the members of which are the CBA Chairman and the policy-related departments. Other departments, the MOF and the Deposit Guarantee Fund (DGF) can participate in the FSSRC at the request of CBA if needed. All key issues regarding financial system stability are discussed in FSSRC during monthly meetings. This body coordinates the interactions within the relevant departments regarding financial system stability issues.</p> <p>In case of an emergency situation, all main issues related to the financial crisis management process are discussed by the FSSRC, which examines the situation based on the information provided by FSD and FSSDD, to assess whether the situation is either stable or a crisis. In case of qualifying the situation as a crisis, FSSRC creates a Working group with the participation of the policy-related departments. The Working group must develop an Action Plan for solving the situation and restoring financial stability. If necessary, other departments may also participate in the elaboration of the Plan. Based on the recommendations and conclusions provided by the Working group the FSSRC makes decisions and gives assignments to relevant departments.</p> <p>In case of a systemic impact or by the decision of the FSSRC the package of proposals and the Action Plan minutes of the session should be submitted for the approval of the Board of CBA.</p> <p>For the purpose of dealing with an emergency situation, a detailed Crisis Management Guide (CMG) has been prepared and is currently in the validation phase. The purpose of the guide is to set forth step by step procedures, timely measures and management decisions.</p> <p>An MOU has been signed between the CBA, the MOF and DGF on September 30, 2010 on cooperation on maintenance of financial stability, crisis preparedness and crisis management.</p>
EC2	Arrangements, formal or informal, are in place for cooperation, including analysis and sharing of information, and undertaking collaborative work, with relevant foreign supervisors of banks and banking groups. There is evidence that these arrangements work in practice, where necessary
Description and findings re EC2	<p>Armenia is a host country but has no responsibilities as a home country supervisor. The only subsidiary of an Armenian bank that had overseas operations was sold by the bank to its shareholder in 2013, after which this subsidiary became a sister company. The bank's license was subsequently revoked in 2017.</p> <p>According to new Article 8 of LCB (Dec. 2017), the Central Bank may without an international agreement or an MoU receive from or provide to foreign financial supervisory authorities any supervisory information (including those containing confidential</p>

	<p>information), if the information is needed for the foreign supervisory authority to meet its supervisory responsibilities, as well as if this authority has an adequate regime to protect supervision data. Assessors have been provided with examples of exchanges of information with foreign authorities.</p> <p>The CBA has signed MOUs with all home supervisors of foreign banks with a subsidiary in Armenia except the UK Prudential Regulatory Authority which considered that it does not require an MOU to share information. MOUs are signed with the supervisory authorities of Lebanon (2006), Cyprus (2006), Russian Federation (2003), Iran (2007 & 2009), and France (2007).</p> <p>A number of MOUs or agreements on exchange of information have been signed with several other foreign supervisors to help improve the CBA supervisory process: Poland (2012), Germany (2011), Egypt (2002), Ukraine (2004), Georgia (2004), Belarus (2000), Kyrgyz Republic (2017), Syria (2009). A number of Armenian banks have ownership stakes by foreign individuals.</p> <p>Armenia is a member of the Eurasian Economic Union, within which an agreement has been signed about exchange of information, including confidential information, between the supervisory agencies of the member-states.</p> <p>CBA regularly takes part in supervisory colleges of HSBC and VTB Bank.</p> <p>The MOUs with foreign supervisors should be updated and completed to refer to handling problem financial institutions and to the resolution of failing banks, as prescribed by the latest recommendations of the Basel Committee.</p>
EC3	<p>The supervisor may provide confidential information to another domestic authority or foreign supervisor but must take reasonable steps to determine that any confidential information so released will be used only for bank-specific or system-wide supervisory purposes and will be treated as confidential by the receiving party.</p>
Description and findings re EC3	<p>According to new Article 8 of LCB (Dec. 2017), the Central Bank may without an international agreement or an MOU receive from or provide to foreign financial supervisory authorities any supervisory information (including those containing confidential information), if the information is needed for the foreign supervisory authority to meet its supervisory responsibilities, as well as if this authority has an adequate regime to protect supervision data.</p> <p>This arrangement, however, is only feasible when the foreign jurisdiction has similar laws enabling the sharing of confidential information without a signed treat or memorandum.</p> <p>Assessors have been provided with examples of exchanges of information in relation to on-going supervision activities of CBA.</p>
EC4	<p>The supervisor receiving confidential information from other supervisors uses the confidential information for bank-specific or system-wide supervisory purposes only. The supervisor does not disclose confidential information received to third parties without the permission of the supervisor providing the information and is able to deny any demand (other than a court order or mandate from a legislative body) for confidential information in its possession. If the supervisor is legally compelled to disclose confidential information it has received from another supervisor, the supervisor promptly notifies the originating supervisor, indicating what information it is compelled to release and the circumstances surrounding the release. Where consent to passing on confidential information is not given, the supervisor uses all reasonable means to resist such a demand or protect the confidentiality of the information.</p>

Description and findings re EC4	Confidential information sharing is governed by the Bank Secrecy Law. It defines the cases where the CBA is allowed to share information with other parties and it is completed by new Article 8 of LCB (Dec. 2017) where the Central Bank may without an international agreement or an MOU receive from or provide to foreign financial supervisory authorities any supervisory information (including those containing confidential information (see EC3).
EC5	Processes are in place for the supervisor to support resolution authorities (e.g., central banks and finance ministries as appropriate) to undertake recovery and resolution planning and actions.
Description and findings re EC5	The Central Bank is itself the resolution authority in the financial system of Armenia. A crisis management framework is under preparation (see EC 1).
Assessment of Principle 3	Largely Compliant
Comments	<p>MOUs with foreign supervisors should be revisited to refer to handling problem financial institutions and to the resolution of failing banks, as prescribed by the latest recommendations of the Basel Committee and the Financial Stability Board (FSB). Formal procedures or processes should be agreed between the CBA and relevant supervisors on how a bank would be resolved in practice.</p> <p>The authorities should consider completing and publishing a comprehensive MOU with the MOF to ensure information sharing, coordination, cooperation and also promote greater accountability and transparency.</p> <p>There is also a MOU signed between the CBA, DGF and MOF in 2010 on cooperation and information exchange during crisis. According to the MOU the parties should have meetings in crisis situations to discuss measures to be taken by the parties. In 2013, amendments have been done in the MOU, particularly (i) the Ministry of Finance shall take part in the financial stability committee meetings in cases when public/budget funds are needed in crisis situations, (ii) the Deposit guarantee fund (DGF) shall take part in the financial stability committee meetings when there is a case of deposit remuneration in crisis situations. Since the MOU was signed, no meetings have been held in the absence of crisis situation.</p> <p>The MOU signed with the MOF and the Deposit Guarantee Fund (DGF) on August 31, 2015, has for sole purpose to avoid potential conflict of interest in the decision-making process of the Fund.</p>
Principle 4	Permissible activities. The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined and the use of the word “bank” in names is controlled.
Essential criteria	
EC1	The term “bank” is clearly defined in laws or regulations.
Description and findings re EC1	Article 4 of the LBB defines “bank” as a legal entity authorized to engage in banking activities under a license issued accordingly to this law. Banking activity is defined as the acceptance of deposits or the offer to accept deposits and the placement of these deposits through loans, deposits and/or investments made on behalf of and at the risk of the accepting party.
EC2	The permissible activities of institutions that are licensed and subject to supervision as banks are clearly defined either by supervisors, or in laws or regulations.
Description and findings re EC2	Article 34 amended in October 2017 of the LBB defines the activities that can be carried out by banks. They include accepting deposits, extending credit, issuing guarantees, making investments, buying and selling foreign exchange, etc. The main amendment is related to

	the introduction of a possibility for banks to outsource (point 3) their activities with prior consent of the CBA. Recently, the CBA Board has approved the procedure giving the prior consent for outsourcing (see also CP 25, EC 8).
EC3	The use of the word “bank” and derivations such as “banking” in a name, including domain names, is limited to licensed and supervised institutions in all circumstances where the general public might otherwise be misled.
Description and findings re EC3	Article 6 of the LBB restricts the usage of the word “bank” and variations thereof to entities possessing a banking license “except where the usage of the word is permitted by law or an international agreement or where it is obvious that its usage has no reference to banking activities.”
EC4	The taking of deposits from the public is reserved for institutions that are licensed and subject to supervision as banks. ⁹
Description and findings re EC4	Article 903 of the Civil Code defines that only banks can accept deposits. Such rights are granted through a banking license. Non-banking financial institutions are not allowed to take deposits.
EC5	The supervisor or licensing authority publishes or otherwise makes available a current list of licensed banks, including branches of foreign banks, operating within its jurisdiction in a way that is easily accessible to the public.
Description and findings re EC5	The list of licensed banks is published on the CBA website.
Assessment of Principle 4	Compliant
Comments	Only banks can accept deposits and conduct banking activities defined as both accepting deposits and extending credit. Non-banking financial institutions are not allowed to take deposits.
Principle 5	Licensing criteria. The licensing authority has the power to set criteria and reject applications for establishments that do not meet the criteria. At a minimum, the licensing process consists of an assessment of the ownership structure and governance (including the fitness and propriety of Board members and senior management)¹⁰ of the bank and its wider group, and its strategic and operating plan, internal controls, risk management and projected financial condition (including capital base). Where the proposed owner or parent organization is a foreign bank, the prior consent of its home supervisor is obtained.
Essential criteria	
EC1	The law identifies the authority responsible for granting and withdrawing a banking license. The licensing authority could be the banking supervisor or another competent authority. If

⁹ The committee recognizes the presence in some countries of non-banking financial institutions that take deposits but may be regulated differently from banks. These institutions should be subject to a form of regulation commensurate to the type and size of their business and, collectively, should not hold a significant proportion of deposits in the financial system.

¹⁰ This document refers to a governance structure composed of a broad and senior management. The Committee recognizes that there are significant differences in the legislative and regulatory frameworks across countries regarding these functions. Some countries use a two-tier board structure, where the supervisory function of the board is performed by a separate entity known as a supervisory board, which has no executive functions. Other countries, in contrast, use a one-tier board structure in which the board has a broader role. Owing to these differences, this document does not advocate a specific board structure. Consequently, in this document, the terms “board” and “senior management” are only used as a way to refer to the oversight function and the management function in general and should be interpreted throughout the document in accordance with the applicable law within each jurisdiction.

	the licensing authority and the supervisor are not the same, the supervisor has the right to have its views on each application considered, and its concerns addressed. In addition, the licensing authority provides the supervisor with any information that may be material to the supervision of the licensed bank. The supervisor imposes prudential conditions or limitations on the newly licensed bank, where appropriate.
Description and findings re EC1	<p>The CBA is both the licensing authority and the supervisory authority. Article 20 of the LCB gives the power to the CBA to grant banking licenses and to declare them invalid. Article 36(2) of the LCB states the CBA shall be empowered by law to license banking activities, set prudential standards and also enforce penalties and sanctions on banks.</p> <p>According to Regulation 1 on "Registration and licensing of banks and branches of foreign banks, registration of banks' branches and representative offices, qualification and registration of the managers of banks and branches of foreign banks", the license process is divided in three phases: prior consent, registration of the future bank as a legal person, licensing.</p> <p>No license application has been granted nor rejected in the recent past. However, in the last five years, four commercial banking licenses have been surrendered as a result of the minimum total capital increase to 30 billion AMD by CBA does not impose additional prudential conditions or temporary limitations on a newly licensed bank.</p>
EC2	Laws or regulations give the licensing authority the power to set criteria for licensing banks. If the criteria are not fulfilled or if the information provided is inadequate, the licensing authority has the power to reject an application. If the licensing authority or-supervisor determines that the license was based on false information, the license can be revoked.
Description and findings re EC2	Article 29 (1) of the LBB sets out the broad criteria for the licensing of banks. Inter alia, these criteria relate to minimum capital, internal organizational structure, fitness and probity of proposed staff, consent of home supervisory authority where relevant. Article 29 (3) of the LBB provides that the CBA may reject an application if the criteria are not met or if information is inadequate. Article 32 of the LBB provides that the CBA may revoke a license if it has been granted on false information.
EC3	The criteria for issuing licenses are consistent with those applied in ongoing supervision
Description and findings re EC3	Criteria set up by Regulation 1 are consistent with on-going supervisory requirements
EC4	The licensing authority determines that the proposed legal, managerial, operational and ownership structures of the bank and its wider group will not hinder effective supervision on both a solo and a consolidated basis. ¹¹ The licensing authority also determines, where appropriate, that these structures will not hinder effective implementation of corrective measures in the future.
Description and findings re EC4	Articles 26(1)(d) and 27(3) of the LBB provides that the CBA can reject an application if the proposed ownership structure hinders effective supervision. However, in the past five years the Central Bank of Armenia has not received any applications for commercial banking licenses from domestic entities.
EC5	The licensing authority identifies and determines the suitability of the bank's major shareholders, including the ultimate beneficial owners, and others that may exert significant influence. It also assesses the transparency of the ownership structure, the sources of initial capital and the ability of shareholders to provide additional financial support, where needed.

¹¹ Therefore, shell banks shall not be licensed (Reference document: BCBS paper on shell banks, January 2003).

Description and findings re EC5	<p>Article 18 of the LBB and Regulation 1 provide that the CBA must satisfy itself about the suitability of all qualifying shareholders (i.e., holders of ten percent or more of the capital), either directly or indirectly, right up to the beneficial owner. Any change in qualifying ownership must have the prior approval of the CBA. In addition, as part of the application review process, the qualifying shareholders should provide information about the sources of their funds, and the CBA assesses the willingness and ability of shareholders to supply additional financial support to the bank in case of deterioration of its financial situation.</p> <p>The law does not explicitly define the “ultimate beneficial owner,” but LBB defines the “indirect significant participant,” which includes also the UBO. When acquiring significant participation, the party is required to get the CBA’s prior consent, for which the party submits a package of documents to the Central Bank. If any person acquires indirect significant participation through any of the significant participants, then the whole package of documents should be submitted also for the indirect significant participant, unless the party declares that he is the ultimate beneficial owner of the bank and no one acquires any further indirect participation in the bank. The parties are obliged to inform the CBA on an ongoing basis about any changes to the information submitted within the procedure of acquisition of significant participation.</p>
EC6	A minimum initial capital amount is stipulated for all banks.
Description and findings re EC6	<p>Regulation 2 stipulate a minimum capital of AMD 30 billion for all banks. The increase in minimum capital from AMD 5 billion to AMD 30 billion was introduced in 2014 and became mandatory from January 1, 2017. CBA cannot, as previously, reduce the minimum capital amount to 1 billion if an applicant shareholder is an institution with an A credit rating and proposes to acquire more than 51 percent of the bank.</p> <p>No additional capital is required for opening branch offices by domestic banks. In case of a foreign bank branch, the foreign bank is required to deposit 200 million AMD in the CBA or a commercial bank during the period of its branch activity.</p>
EC7	The licensing authority, at authorization, evaluates the bank’s proposed Board members and senior management as to expertise and integrity (fit and proper test), and any potential for conflicts of interest. The fit and proper criteria include: (i) skills and experience in relevant financial operations commensurate with the intended activities of the bank; and (ii) no record of criminal activities or adverse regulatory judgements that make a person unfit to uphold important positions in a bank. ¹² The licensing authority determines whether the bank’s Board has collective sound knowledge of the material activities the bank intends to pursue, and the associated risks.
Description and findings re EC7	<p>Article 29(1)(d) of the LBB sets down the minimum conditions for licensing requirements relating to suitable qualifications and professional integrity of proposed management. Regulation 1 of the CBA defines the criteria of qualification and professional integrity of the proposed management, as well as the checking procedure. The criteria defined by the CBA include the ones mentioned in this EC.</p> <p>Fit and proper assessments are conducted by the Central Bank of Armenia as part of Bank manager’s registration process, as well as during the process of giving preliminary consent for significant participation in the bank’s statutory fund. Fit and proper assessment processes and policies of significant shareholders and managers of the bank are prescribed in Regulation 1 and the Licensing Manual of the Central Bank of Armenia.</p> <p>The objective of significant shareholders’ fit and proper assessment is to check for compliance with the requirements of Article 18 of the LBB, otherwise the applicant shall be rejected. The objective of the managers’ fit and proper process assessment is to discover</p>

¹² Please refer to Principle 14, Essential Criterion 8.

	<p>any reason that would prevent a person from being a bank manager according to Article 22 of the LBB.</p> <p>Based on the fit and proper assessments, the Central Bank of Armenia takes decisions regarding the suitability of a Bank's managers and significant shareholders.</p> <p>The other significant part of the "Fit and Proper" assessment is the interviewing of managers, and significant shareholders. Management interviews are conducted according to "Financial institution managers fit and proper assessment guidance." Private sector representatives that met with assessors confirmed that the process was very comprehensive. The following levels are subject to fit and proper assessments: bank's Chairman of the Board, Deputy Chairman, Board members, executive director, Deputy Chairman of the executive board, members of the bank's directorship (executive board), Governor of the branch of a foreign bank, Chief accountant of the bank and the branch of a foreign bank, Deputy chief accountant of the bank and the branch of a foreign bank, Head and members of internal audit unit, Head of the dealers, staff in charge of AML/CFT, governor and chief accountant of the branch of the bank.</p>
EC8	The licensing authority reviews the proposed strategic and operating plans of the bank. This includes determining that an appropriate system of corporate governance, risk management and internal controls, including those related to the detection and prevention of criminal activities, as well as the oversight of proposed outsourced functions, will be in place. The operational structure is required to reflect the scope and degree of sophistication of the proposed activities of the Bank. ¹³
Description and findings re EC8	Articles 25 and 28(1) of the LBB set out the documentation that the CBA must review when considering an application for a banking license. They include a business plan with details on the proposed internal organizational structure, proposed activities, financial projections, as well as financial information on the principal shareholders of the bank.
EC9	The licensing authority reviews pro forma financial statements and projections of the proposed bank. This includes an assessment of the adequacy of the financial strength to support the proposed strategic plan as well as financial information on the principal shareholders of the bank.
Description and findings re EC9	See EC 8.
EC10	In the case of foreign banks establishing a branch or subsidiary, before issuing a license, the host supervisor establishes that no objection (or a statement of no objection) from the home supervisor has been received. For cross-border banking operations in its country, the host supervisor determines whether the home supervisor practices global consolidated supervision.
Description and findings re EC10	Under Article 29(1)(e) of the LBB, the CBA requires the consent of the supervisory authority in the home jurisdiction in respect of a foreign bank proposing to establish in Armenia. Article 26(1)(c) of LBB defines, that the CBA might not provide its preliminary consent to licensing, if "... the Central Bank considers that the banking supervision agencies of the country of incorporation and primary operation of the bank do not implement due control over the bank and its foreign branches as of a single system". The CBA also assess whether the home supervisor practices global consolidated supervision by reviewing their supervision practices and findings of international review organizations.

¹³ Please refer to Principle 29.

EC11	The licensing authority or supervisor has policies and processes to monitor the progress of new entrants in meeting their business and strategic goals, and to determine that supervisory requirements outlined in the license approval are being met.
Description and findings re EC11	All banks including newly licensed ones must submit to the CBA their business plans, approved by their boards, which cover the upcoming three years. During the on-going supervision, the supervisors assess the implementation of these plans.
Assessment of Principle 5	Compliant
Comments	Current laws and regulations cover all the key elements of an effective licensing framework and the approach to assessing the fitness and propriety of major shareholders and senior management of an applicant bank is appropriate. Chief Risk Officer and Head of the compliance functions are not yet included in the interview process, but CBA has prepared a draft amendment to be able to do so.
Principle 6	Transfer of significant ownership. The supervisor has the power to review, reject and impose prudential conditions on any proposals to transfer significant ownership or controlling interests held directly or indirectly in existing banks to other parties.
Essential criteria	
EC1	Laws or regulations contain clear definitions of “significant ownership” and “controlling interest.”
Description and findings re EC1	The concept of “control” is provided in the LCB within the framework of consolidated supervision, with control being defined in accordance with IFRS 10. Article 9 of the LBB defines a significant shareholder (“Qualified Shareholder”) as one who holds 10 percent or more of the voting shares of the legal entity. A shareholder with less than a 10 percent holding can also be regarded as a qualified shareholder (indirect significant participant) if it is in a position to seriously influence decisions of the bank. Additionally, the CBA’s consent is required for each new transaction or transactions if the holding of a person in the capital of a bank exceeds 10 percent, 20 percent, 50 percent or 75 percent.
EC2	There are requirements to obtain supervisory approval or provide immediate notification of proposed changes that would result in a change in ownership, including beneficial ownership, or the exercise of voting rights over a particular threshold or change in controlling interest.
Description and findings re EC2	Article 18(1) of the LBB provides that the CBA must satisfy itself about the suitability of all qualified shareholders, both direct and indirect, right up to the beneficial owner. Any change in qualified ownership must have the approval of the CBA.
EC3	The supervisor has the power to reject any proposal for a change in significant ownership, including beneficial ownership, or controlling interest, or prevent the exercise of voting rights in respect of such investments to ensure that any change in significant ownership meets criteria comparable to those used for licensing banks. If the supervisor determines that the change in significant ownership was based on false information, the supervisor has the power to reject, modify or reverse the change in significant ownership.

Description and findings re EC3	<p>Article 18.2 of the LBB provides that the CBA can reject an application for change of ownership for a variety of reasons including: cases when the person requesting the participation has a criminal record for a deliberately committed crime; is recognized as bankrupt and has outstanding (non-forgiven) liabilities; cases when the transaction is directed or results in, or may result in, a limitation of economic competition; or when documents have been submitted that infringe on the rules prescribed by the Central Bank; or false or unconvincing data is included in the submitted documents or information.</p> <p>Article 57.6 of LBB also states that “if inaccurate, false or incomplete data are presented to the Central Bank during licensing or acquisition of significant participation, or the bank or parties holding significant participation in statutory fund of the bank infringe on the requirements of this Law, or if during the execution of supervision over the bank essential information about deterioration of financial state of bank related parties is detected and it may influence the financial state of the bank or may somehow impede interests of bank depositors or other creditors, the Central Bank is entitled to: (a) propose the party holding significant participation in the bank’s statutory fund to dispose of his investments in the bank or dispose his right of claim by force of which he can affect the activity of the bank by the reason that it impedes the financial state of the bank; (b) apply one of the sanctions to the bank as set forth in Article 61 of this law.”</p> <p>In practice, according to data provided by CBA, the supervisors have approved all transfers of significant ownership that were received in the last five years:</p>										
<table border="1"> <thead> <tr> <th data-bbox="396 915 649 961">2013</th> <th data-bbox="649 915 850 961">2014</th> <th data-bbox="850 915 1019 961">2015</th> <th data-bbox="1019 915 1198 961">2016</th> <th data-bbox="1198 915 1414 961">2017</th> </tr> </thead> <tbody> <tr> <td data-bbox="396 961 649 1125">4 requests, all approved, 2 of them are other significant participations</td> <td data-bbox="649 961 850 1125">1 request, approved</td> <td data-bbox="850 961 1019 1125">6 requests, all approved</td> <td data-bbox="1019 961 1198 1125">10 requests, all approved</td> <td data-bbox="1198 961 1414 1125">7 requests, all approved, 4 of them indirect participation</td> </tr> </tbody> </table>	2013	2014	2015	2016	2017	4 requests, all approved, 2 of them are other significant participations	1 request, approved	6 requests, all approved	10 requests, all approved	7 requests, all approved, 4 of them indirect participation	<p>The CBA explained that the information is being submitted by the applicants to the supervisors while requesting CBA prior consent on acquisition of significant participation. The applicant shall declare that no one else gets the status of indirect significant participant of the bank through his/her participation, otherwise he/she has to submit the information and documents, required by the law and regulation, about the persons, acquiring indirect significant participation. In addition, any change in the information provided should also be submitted to the Central Bank.</p>
2013	2014	2015	2016	2017							
4 requests, all approved, 2 of them are other significant participations	1 request, approved	6 requests, all approved	10 requests, all approved	7 requests, all approved, 4 of them indirect participation							
EC4	The supervisor obtains from banks, through periodic reporting or on-site examinations, the names and holdings of all significant shareholders or those that exert controlling influence, including the identities of beneficial owners of shares being held by nominees, custodians and through vehicles that might be used to disguise ownership.										
Description and findings re EC4	Banks are required to submit reports to the CBA upon each change in ownership. In addition, Chapter 18 of Regulation 1 specifies the list of information, including names and holdings of all significant shareholders submitted regularly by the bank to the Central Bank.										
EC5	The supervisor has the power to take appropriate action to modify, reverse or otherwise address a change of control that has taken place without the necessary notification to or approval from the supervisor.										
Description and findings re EC5	Article 18(2) specifies that any acquisition of a qualified holding in the bank’s statutory capital without the preliminary consent of the CBA shall be void.										

EC6	Laws or regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material information which may negatively affect the suitability of a major shareholder or a party that has a controlling interest.
Description and findings re EC6	According to Regulation 1, qualified shareholders must notify the CBA of any change to the information submitted when seeking authorization for the shareholding. Regulation 1 also requires banks to submit details on affiliates of shareholders (both natural and legal) on an annual basis.
Assessment of principle 6	Compliant
Comments	The CBA has the appropriate powers to approve and reject applications by prospective owners to become substantial shareholders of a bank on both a consolidated and solo bank basis.
Principle 7	Major acquisitions. The supervisor has the power to approve or reject (or recommend to the responsible authority the approval or rejection of), and impose prudential conditions on, major acquisitions or investments by a bank, against prescribed criteria, including the establishment of cross-border operations, and to determine that corporate affiliations or structures do not expose the bank to undue risks or hinder effective supervision.
Essential criteria	
EC1	Laws or regulations clearly define: (a) what types and amounts (absolute and/or in relation to a bank's capital) of acquisitions and investments need prior supervisory approval; and (b) cases for which notification after the acquisition or investment is sufficient. Such cases are primarily activities closely related to banking and where the investment is small relative to the bank's capital.
Description and findings re EC1	Article 35 of the LBB defines the amounts of acquisitions and investments that need prior supervisory approval by CBA. Approval is required for: - the acquisition of 4.99% and above of equity interest in the capital of another entity; - the acquisition of equity interest in the capital of one person exceeding 15% of the bank's total capital; and - the acquisition of equity interest exceeding in total 35% of the bank's total capital. The CBA's prior approval is required for every transaction when the bank's equity interest in the capital of another entity exceeds any of the following thresholds: 9%, 15%, 35%, 50%, 70% or 100% (LBB, Article 35). Chapter 35 of Regulation 1 specifies the documents to be submitted with the application. There are no specific requirements for post notification of acquisition or investment, but the supervisors state that they regularly monitor the bank's acquisitions through regular reports and on-going supervision. The threshold (5%) is quite low so they consider this approach to be conservative.
EC2	Laws or regulations provide criteria by which to judge individual proposals.
Description and findings re EC2	Chapter 35 of Regulation 1, as well as Article 35 of the LBB describes the criteria under which the proposal of prior approval of acquisition is judged. Article 35(3) of the LBB stipulates that the CBA will grant approval for the acquisition if the prospective financial transaction is compatible with the financial condition of the bank and would contribute towards the development of activities of the bank in the financial market.
EC3	Consistent with the licensing requirements, among the objective criteria that the supervisor uses, is that any new acquisitions and investments do not expose the bank to undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective

	implementation of corrective measures in the future. ¹⁴ The supervisor can prohibit banks from making major acquisitions/investments (including the establishment of cross-border banking operations) in countries with laws or regulations prohibiting information flows deemed necessary for adequate consolidated supervision. The supervisor takes into consideration the effectiveness of supervision in the host country and its own ability to exercise supervision on a consolidated basis.
Description and findings re EC3	The criteria referred to in EC 2 include the requirement that the investment must be compatible with the financial condition of the bank. In case of the acquisition of a bank operating abroad or the participation or the establishment of a bank operation abroad, the requirements specify that the authority responsible for banking supervision in the foreign country must supervise the bank duly and consistently with international standards. The foreign country must also give the CBA the opportunity to audit or duly supervise the activity of these banks. The CBA has the authority to prohibit banks from making investments in countries with secrecy laws or other regulations prohibiting information flows deemed necessary for adequate consolidated supervision. Regulation 1 (point 232) requires that the acquisition does not expose the bank to undue risk or that the bank has adequate financial and organizational resources to handle the acquisition.
EC4	The supervisor determines that the bank has, from the outset, adequate financial, managerial and organizational resources to handle the acquisition/investment.
Description and findings re EC4	Article 35(3) of the LBB stipulates that the CBA will grant approval for the acquisition if the prospective financial transaction is compatible with the financial condition of the bank and would contribute towards the development of activities of the bank in the financial market. Point 232(6) of Regulation 1 states that: "The bank may get the prior consent of the Central Bank about the intended transaction, if: ... as a result of the given transaction, no undue risks will arise for the bank and the bank will have respective organizational resources for conduction of the given transaction"
EC5	The supervisor is aware of the risks that non-banking activities can pose to a banking group and has the means to take action to mitigate those risks. The supervisor considers the ability of the bank to manage these risks prior to permitting investment in non-banking activities.
Description and findings re EC5	The CBA is aware of the risks that non-banking activities can pose to a banking group. Banking groups in Armenia are not involved directly or indirectly through a subsidiary in non-financial activities. The thresholds for approval of major acquisitions are relatively low. In addition, CBA regularly receives reports about intragroup transactions in banking groups that includes also transactions with related non-bank counterparties. Point 230(3) of Regulation 1 states that for the purpose of getting the prior consent of the Central Bank a bank submits a business plan to the Central Bank, which shall include information on the probability of achieving success as a result of implementing such transactions or operations.
Additional Criteria	
AC1	The supervisor reviews major acquisitions or investments by other entities in the banking group to determine that these do not expose the bank to any undue risks or hinder effective supervision. The supervisor also determines, where appropriate, that these new acquisitions and investments will not hinder effective implementation of corrective

¹⁴ In the case of major acquisitions, this determination may take into account whether the acquisition or investment creates obstacles to the orderly resolution of the bank.

	measures in the future. ¹⁵ Where necessary, the supervisor is able to effectively address the risks to the bank arising from such acquisitions or investments.
Description and findings re AC1	Other financial institutions involved in the banking group are subject to supervision simultaneously with the bank. As the Central Bank is the sole supervisor of the financial system, it has broad understanding of all risks, emerging from other financial entities of the banking group, including the risks emerging from major acquisitions or investments by other entities in the banking group. During preparation of the annual off-site report, the supervisor also analyses the financial situation of non-financial organizations, involved in the banking group. Some aspects that are analyzed include turnover of the organization, financial indicators, credit burden, etc. In the case of major acquisitions or investments made by non-financial organizations, the CBA takes that information into consideration, while preparing the annual off-site report. However, it is not explicitly regulated by any legal act.
Assessment of Principle 7	Compliant
Comments	The CBA has the legal powers to approve or reject acquisitions or investments by a bank. As part of the consolidation of the Armenian banking system, the CBA reviewed and approved four requests for acquisitions linked to mergers of banks since the last assessment.
Principle 8	Supervisory approach. An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable.
Essential Criteria	
EC1	The supervisor uses a methodology for determining and assessing on an ongoing basis the nature, impact and scope of the risks: (a) which banks or banking groups are exposed to, including risks posed by entities in the wider group; and (b) which banks or banking groups present to the safety and soundness of the banking system. The methodology addresses, among other things, the business focus, group structure, risk profile, internal control environment and the resolvability of banks, and permits relevant comparisons between banks. The frequency and intensity of supervision of banks and banking groups reflect the outcome of this analysis.
Description and findings re EC1	Until 2015 the CBA conducted a supervisory program that was largely compliance based, identifying compliance with laws and regulations, but not forward looking with regard to identifying potential risks in the material business lines of the banks. Inspections were mostly full scope, lasting several months in most cases, and based on a fixed cycle - conducted with a frequency of up to every five years. Targeted prudential inspections were not common. Supervisory activities between examinations were generally limited to the review of reports on financial condition trends; but not changes in business strategies or risk management practices. The CAMELS rating system was employed, but it was used to assess current financial ratios and condition; it was not used as a forward-looking tool. The CBA has undergone a major reform over the past three years to transition to a more risk-based and forward-looking supervisory (RBS) framework. A new supervisory

¹⁵ Please refer to Footnote 33 under Principle 7, Essential Criterion 3.

	<p>methodology for determining and assessing the risks to which individual banks are exposed and the systemic impact of individual banks was designed with the assistance of the Toronto Centre. Piloting began in 2015 with three banks, two more in 2016, and the remaining twelve were added in 2017. Considerable training with regard to the risk assessment and supervisory planning processes was undertaken in 2017 for the majority of FSD staff. The supervisory plan currently runs from October through September, hence the activities now under way are based on the June 2017 assessment. The program was announced officially as operational in January 2018. The program differs substantially from the previous program in that it is focused on understanding the business strategy of the firms and identifying the material operations that contribute to the execution of that strategy. Once identified, an ongoing cycle of supervisory activities (targeted on-site and off-site inspections) are conducted to assess the firm and close knowledge gaps for future planning. This new process required a re-organization of the department into groups of supervisors with continuous institution oversight responsibilities and Risk Teams charged with developing deeper knowledge and expertise regarding specific risks, assessing risk across the entire system, as well as providing exam support to firm specific teams.</p> <p>To be more specific, under the RBS framework the risk profile of each bank is summarized in an individual risk matrix which is underpinned by quantitative analysis and supervisory judgment. Material operations across the entire banking organization are identified based on their impact on the banking organization (e.g., asset size, income/profitability, RWA/capital, business strategy, systemic impact). Material operations always include AML/CFT monitoring, IT systems management, and asset/liability management. Each of these operations is assessed for inherent risk across multiple factors: credit, market (including interest rate, FX, and price risk), operational, compliance and strategic. Both the identification of material operations and inherent risk evaluation include a qualitative, forward-looking expectation of how these operations may grow or evolve into new products or markets. Baseline assessments of inherent risks are made by risk teams created within the FSD responsible for maintaining a view of each risk across the banking system, thus enabling a benchmarking against other banks and CBA standards, as well as identifying which banks present material risks to the system. Based on these baseline risk assessments, supervisors then consider the specifics of banks' significant activities and related inherent risk factors which drive the level of the inherent risk higher or lower than those baseline assessments. Inherent risks are then evaluated against the effectiveness of management and controls, and a "net risk" position for each material operation is developed. The management and control evaluation of effectiveness in mitigating inherent risk addresses multiple tiers including the traditional three lines of defense (operations, compliance/ risk, and internal audit) as well as executive management and the Board. Where supervisors assess higher levels of inherent risks, they develop more rigorous expectations. Based on this "net risk" for each material activity, its relative importance to the overall risk profile of the firm is assessed.</p> <p>Each bank's capital, earnings, and liquidity position are assessed for adequacy against the net risks of these material operations on a four-point scale. A single composite risk rating is determined after consideration of the financial strength of the firm. While a CAMELS based financial rating is still prepared using submitted regulatory reports, the risk assessment components and composite are now the primary means of assessing the supervisors' views.</p>
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	Significant transaction	Intrinsic risk								Quality of risk management						Net risk	Net risk trend	Level of importance of net risk	
		Credit	Interest rate	Foreign exchange	Pricing	Underwriting	Operational	Compliance	Strategic	Operations management	Ensuring compliance	Risk management	Actuarial	Internal audit	Executive body				Board of directors
N	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19
1																			
2																			
...																			
Composite risk rating																	Composite net risk rating	Overall net risk area	
		INCOME								RATING						TREND			
		CAPITAL																	
		LIQUIDITY																	
		OVERALL RISK																	

Based on the risk matrices of banks, annual supervisory plans are developed for supervisors with bank specific responsibilities and for risk teams to conduct horizontal or thematic reviews across banks. Activities are planned to monitor both inherent risks and to address supervisory knowledge gaps in mitigating controls. Supervisory activities (both on-site and off-site) are conducted during the year based on these risk matrices and results are summarized and factored into the updating of the matrices. Banks receive and respond to results of supervisory activities throughout the annual supervisory cycle.

With regard to the application of the new RBS framework to financial groups, annually supervisors review the ownership structure including all related companies and affiliated companies. If a group is determined to be not low risk (see CP 12) a similar risk-based program is applied which adds requirements for assessing the impact of other affiliates, inter-group transactions, and reputational and contagion risk. For groups identified as low risk, there is still consideration of the impact of ownership groups and related parties as well as a review of inter-group transactions via regulatory reporting. Currently, all the four financial groups are identified as low risk.

The CBA allocates resources more proportionately to its identified systemic banks by assigning more institution specific examiners and by limiting their non-systemic work responsibilities, more frequent analysis of large borrowers, preparing off-site analysis reports based on management reports monthly rather than quarterly, and conducting more targeted inspections in these firms than for smaller firms.

EC2	The supervisor has processes to understand the risk profile of banks and banking groups and employs a well-defined methodology to establish a forward-looking view of the profile. The nature of the supervisory work on each bank is based on the results of this analysis.
Description and findings re EC2	See EC 1.
EC3	The supervisor assesses banks' and banking groups' compliance with prudential regulations and other legal requirements.
Description and findings re EC3	The CBA assesses compliance with prudential regulations as a part of its review of material operations as discussed under EC 1. Furthermore, the CBA requires extensive reporting on prudential standards (e.g., capital, asset quality, liquidity, FX risk) and reviews compliance

	weekly/monthly. High risk banking groups are required to calculate all prudential ratios described in Regulation 2 on a consolidated basis (except for reserve requirements and foreign currency disposition standards), as well as intragroup transactions.
EC4	The supervisor takes the macroeconomic environment into account in its risk assessment of banks and banking groups. The supervisor also takes into account cross-sectoral developments, for example in non-bank financial institutions, through frequent contact with their regulators.
Description and findings re EC4	<p>In 2016, a joint effort by the Financial Supervision Department (FSD) and Financial System Stability and Development Department (FSSDD) developed a reporting template titled "Macroeconomic Risks Affecting Financial System Stability" (macro report). Since Q3/2016, the FSSDD has prepared this macro report and submitted it to the FSD supervisors on a quarterly basis, so that the latter can take it into account in banks' risk assessment process (e.g., risk matrix, regular off-site analysis). In the risk matrix, for all components, there is a "direction of net risk" indicator, which shows the supervisor's expectation as to further probable change in the rating of the given component. The macro report is currently used to assist in deriving those directions. The macro report has the following structure:</p> <ol style="list-style-type: none"> 1) External environment (e.g., actual and forecasted GDP growth rates of major partner economies, interest rates, commodity price level dynamics, etc.); 2) Domestic economy (analysis of factors affecting demand and supply in the economy, trends and forecasts in selected economic sectors, actual/forecasted domestic GDP growth rates, etc.); 3) Results of quarterly credit conditions survey; and, 4) Selected macro-economic indicators. <p>This macro report is prepared based on the quarterly Inflation Report prepared by the Monetary Policy Department, weekly analytical reports prepared by the Financial Department (information from Bloomberg, Reuters), quarterly reports from State Cadaster, Global Financial Stability report by IMF (semi-annual), other news, as well as loan condition surveys by Statistics Department.</p> <p>There is continuous monitoring in place regarding macro-economic and financial system indicators. FSSDD prepares reports, which comprise information on recent developments in global and domestic economies, developments of financial markets, changes of financial soundness indicators of financial institutions and developments of macro-economic risks that can impact the financial (banking) sector. Taking into account the results of the abovementioned monitoring, FSSDD conducts quarterly reporting for FSSRC, quarterly macro-economic stress tests of banking system and banks separately to assess the possible losses due to various adverse macro-economic scenarios (baseline, mild, severe) and to check resilience of banks and the banking system as a whole. Based on the abovementioned monitoring and stress tests results FSSDD prepares and submits reports to FSSRC, which are also shared with the FSD supervisors.</p> <p>As the CBA has supervisory responsibility across the entire financial sector, cross-sectoral developments are communicated across the CBA.</p>
EC5	The supervisor, in conjunction with other relevant authorities, identifies monitors and assesses the build-up of risks, trends and concentrations within and across the banking system as a whole. This includes, among other things, banks' problem assets and sources of liquidity (such as domestic and foreign currency funding conditions, and costs). The supervisor incorporates this analysis into its assessment of banks and banking groups and addresses proactively any serious threat to the stability of the banking system. The supervisor communicates any significant trends or emerging risks identified to banks and to other relevant authorities with responsibilities for financial system stability.

Description and findings re EC5	<p>On the level of individual banks FSD receives daily, weekly, monthly, quarterly and yearly reports. On a weekly basis, a monitoring report of all significant bank transactions is presented to the Head of FSD. Prudential indicators are monitored and analysis on major changes is performed for big banks monthly, for smaller banks this analysis is performed on a quarterly basis. All the prudential ratios and their dynamics are monitored including: balance sheet changes, capital, loan portfolio details (growth rate, structure, concentrations, NPLs), liquidity ratios, FX positions, asset/liability term gaps, and sensitivity ratios. Supervisors also prepare quarterly analysis of significant changes that may occur based on ongoing monitoring of each firm. These changes address both financial trends as well as changes in business operations, strategies, and management. Within FSD, the supervisory monitoring and assessment of risks, trends and concentrations across the banking system is done by risk teams via both off-site analysis and thematic inspections and reviews. Until now, these risk teams have conducted thematic studies on restructured loans, strategic plans, operational risks, AML/CFT risks, etc. on a system-wide level. The results of those studies and assessments have been shared with responsible supervisors of all banks, while the latter have taken them into consideration in their day-to-day supervision over those banks.</p> <p>FSSDD is responsible for assessment of systemic risks and revealing risk accumulations in the financial system. FSSDD reviews various financial indicators such as changes in assets, loans, deposits and funding sources, FX position (daily) and other balance sheet essential movements on a weekly basis. Core indicators of financial soundness are monitored on a monthly and quarterly basis. Among these, the following are used as early warning indicators: Deposits/GDP, Assets/GDP, Credit/GDP, loan to deposits, real estate prices, spreads of interest rates, growth of assets, loans (to natural and to legal entities) and deposits, NPL/ Assets, and liquidity ratios. In addition to the macro-economic stress tests, FSSDD also conducts various "what if" scenario stress tests for liquidity risk (deposit outflow), credit risk (stricter provisioning options, deterioration of credit portfolio, default of largest borrower), commodity price risk (real estate price variation), interest risk (duration, Gap) and FX risk (VAR).</p> <p>Based on the results of the abovementioned analysis, monitoring and assessment, FSSDD prepares and submits reports to FSSRC, the latter decides to apply the risk mitigation tools or submit such a recommendation for the approval of the Board. There are several types of risk mitigation tools available, including: stricter requirements on capital (e.g. provisioning and risk weights for FX exposures) and on liquidity (e.g., FX liquidity ratio) and constraints on borrowing ability (LTV, DTI).</p>
EC6	Drawing on information provided by the bank and other national supervisors, the supervisor, in conjunction with the resolution authority, assesses the bank's resolvability where appropriate, having regard to the bank's risk profile and systemic importance. When bank-specific barriers to orderly resolution are identified, the supervisor requires, where necessary, banks to adopt appropriate measures, such as changes to business strategies, managerial, operational and ownership structures and internal procedures. Any such measures take into account their effect on the soundness and stability of ongoing business.
Description and findings re EC6	<p>The CBA is the only designated resolution authority. At this time, there have been no specific resolvability assessments.</p> <p>Should bank specific barriers ultimately be identified, it appears the CBA has the necessary authority to require banks to adopt the appropriate remediation measures. Specifically, according to Article 39.10 of LCB, in order to improve the financial condition or run the normal business of a bank, the Central Bank may enter into an agreement with a bank to require any of the following:</p>

	<ul style="list-style-type: none"> • Implement a program of re-organization or development within a specified time-schedule, • Take measures to remedy violations, • Suspend the payment of dividends, • Set tighter prudential economic standards, • Reduce the managers' salaries and terminate premiums, • Terminate assets and (or) liabilities/side operations or restrict targeting, • Restrict advertising, • Other restrictions, necessary to improve the financial condition or run a normal business of the bank. <p>Further, as stipulated by Article 41 of the LBB, for the purpose of restraining risks in banking activities the CBA may provide for limitations on or special rules of procedure for the bank's lending, deposit, financial operations, and certain types of investments.</p>
EC7	The supervisor has a clear framework or process for handling banks in times of stress, such that any decisions to require or undertake recovery or resolution actions are made in a timely manner.
Description and findings re EC7	<p>The CBA's RBS framework addresses the need for timely identification of significant financial risks and managerial weaknesses, including the conduct of root cause analysis to determine the need for corrective action. The RBS framework also provides for regular reporting (monthly or quarterly based on size/complexity) of compliance with all prudential standards and significant risk profile changes to the Head of FSD for advising the Licensing and Supervision oversight committee. The CBA has provided evidence of having taken steps to address deficiencies in capital, reserves and risk management, either formally via sanctions, or informally through the supervisory process.</p> <p>It is also noted that the proposed regulation implementing Basel III capital buffers institutes restrictions on dividends and compensation tied to maintenance of the buffers.</p> <p>With regard to decisions to affect a bank resolution, the CBA monitors insolvency factors outlined in Article 2.1 of the Law on "Bankruptcy of banks, credit organizations, investment companies, investment fund managers and insurance companies," which are as follows:</p> <ul style="list-style-type: none"> (a) Bank has consumed 50% or more of its core capital; or (b) it is unable to satisfy the legitimate claims of its creditors, or (c) the summary assessment of bank performance is lower than the summary assessment of bank performance defined by the Board of the CBA, or (d) it violates, at regular basis, the mandatory reserve requirement prescribed by law. <p>Where any of the insolvency grounds prescribed by the Law on Bankruptcy has been identified, the CBA may, within a period of 2 weeks: (a) appoint a head of temporary administration or (b) file an application with the court for the bankruptcy of the bank.</p>
EC8	Where the supervisor becomes aware of bank-like activities being performed fully or partially outside the regulatory perimeter, the supervisor takes appropriate steps to draw the matter to the attention of the responsible authority. Where the supervisor becomes aware of banks restructuring their activities to avoid the regulatory perimeter, the supervisor takes appropriate steps to address this.
Description and findings re EC8	Article 4 of LBB prohibits undertaking of banking activities in the territory of the Republic of Armenia without a license, issued by the Central Bank. Where the Central Bank becomes aware of bank-like activities being performed outside the regulatory perimeter, it may contact law enforcement authorities to take respective measures. Article 169 of Administrative Offence Code of the RA, as well as Articles 188, 188.1 and 189 of Criminal Code of the RA define the sanctions against such activity. Where the CBA becomes aware

	<p>of banks, restructuring their activities to avoid the regulatory perimeter, it is authorized to take appropriate steps to address this.</p> <p>This has not been a significant issue for the CBA.</p>
Assessment of Principle 8	Largely Compliant
Comments	<p>The CBA has made significant improvements in its approach to banking supervision with adoption of the RBS framework. It provides a forward-looking assessment of the risk profile of individual banks and groups and assigns resources more proportionate to the risks in the system, and to the risks within individual banks. The use of risk teams to take ownership of individual risks across the banking system also contributes to identification and monitoring of risks emanating from banks and the banking system as a whole. Input from the financial stability group into the identification of systemic firms and background on macroeconomic trends is also incorporated into the assessment. Although supervisors have a good understanding of the overall quality of bank management, the RBS approach has revealed a lack of structured information on risk management activities of banks. This is being addressed through annual supervisory plans of individual banks and risk teams. Also, there is a need to enhance supervisory guidance and clarify expectations for risk management.</p> <p>The lack of a specific bank resolution regime is not a ground for downgrade of this Core Principle but it intensifies the uncertainties associated with a bank resolution. Irrespective of any changes to the resolution regime, it is recommended that the CBA review the existing bankruptcy framework to determine if barriers exist to a timely and orderly bank resolution process, and whether there are steps that need to be taken in advance to address resolvability issues.</p> <p>The CBA should consider adopting a Prompt Corrective Action framework that incrementally stages intervention strategies as a bank's financial condition deteriorates. The framework can serve as a useful tool for incentivizing banks to address their weaknesses pro-actively and before supervisory interventions become necessary.</p>
Principle 9	Supervisory techniques and tools. The supervisor uses an appropriate range of techniques and tools to implement the supervisory approach and deploys supervisory resources on a proportionate basis, taking into account the risk profile and systemic importance of banks.
Essential Criteria	
EC1	<p>The supervisor employs an appropriate mix of on-site¹⁶ and of-site¹⁷ supervision to evaluate the condition of banks and banking groups, their risk profile, internal control environment and the corrective measures necessary to address supervisory concerns. The specific mix between on-site and off-site supervision may be determined by the particular conditions and circumstances of the country and the bank. The supervisor regularly assesses the quality, effectiveness and integration of its on-site and off-site functions, and amends its approach, as needed.</p>

¹⁶ On-site work is used as a tool to provide independent verification that adequate policies, procedures and controls exist at banks, determine that information reported by banks is reliable, obtain additional information on the bank and its related companies needed for the assessment of the condition of the bank, monitor the bank's follow-up on supervisory concerns, etc.

¹⁷ Off-site work is used as a tool to regularly review and analyze the financial condition of banks, follow up on matters requiring further attention, identify and evaluate developing risks and help identify the priorities, scope of further off-site and on-site work.

Description and findings re EC1	<p>Planning for all supervisory activities (on-site and off-site) is based on the most recent risk assessment matrix as discussed more fully in CP 8, EC 1. The risk matrix summarizes the current assessment of all material operations of the bank by considering the inherent risks and mitigating management controls in place. The most important issues and knowledge gaps identified in the analysis underpinning the risk matrix are considered for inclusion in the annual supervisory plan of each bank. The annual supervisory plan per bank has the following structure:</p> <ul style="list-style-type: none"> • Timeline by quarters • Main Issue/Significant Activity • Brief description of Issue problem • Planned Supervisory Action • Supervision Tool (inspection vs. off-site) • Expected Outcome • Required Supervisory Resources <p>Similarly, risk teams are also leveraging from the risk assessment matrices of all banks to identify risk and control areas for off-site analysis, thematic inspections or thematic studies per their respective risks. In the beginning of each planning cycle, “brainstorming” sessions within each risk team are used to identify and prioritize possible supervisory activities. Supervisory plans are harmonized among risk teams and bank supervisors to integrate their activities where possible and prioritize the allocation of resources. The annual supervisory plans per bank and per risk teams are to be updated on a semi-annual basis.</p> <p>The RBS program was declared operational in January 2018, after piloting the program for five banks in 2016 and adding the remaining twelve banks in 2017. However, a rather limited number of targeted prudential inspections were performed in 2017 owing to the transitioning of twelve banks to the program last year. The transition required significant training to adopt to new procedures and prepare initial risk assessment and supervisory planning products. Only seven prudential target reviews were completed, and those were aimed at the five banks already in the pilot program. The supervisory plans currently in place for 2018 contemplate over 40 supervisory activities spread across all 17 banks in the system.</p> <p>Assessors reviewed a sample of risk assessment matrices and it appeared supervisors have significant information gaps. For three firms we reviewed, the risk assessment matrices for each were marked as “Incomplete” regarding the assessment of certain management and control mitigants. CBA managers explained that matrices in 2017 were based on last available on-site inspection reports (where feasible), off-site information and other information drawn from frequent meetings and calls with banks. Since this did not fully cover the new requirements, and in particular with respect to QRM assessments, information gaps naturally arose which are being addressed in annual supervisory plans.</p>
EC2	The supervisor has a coherent process for planning and executing on-site and off-site activities. There are policies and processes to ensure that such activities are conducted on a thorough and consistent basis with clear responsibilities, objectives and outputs, and that there is effective coordination and information sharing between the on-site and off-site functions.
Description and findings re EC2	See EC 1. above. The organizational model of the FSD does not have separate staff to conduct on-site vs. off-site activities. Staff are divided among Financial Institutions (FI staff) and Risk Teams. Within those groups, a variety of on-site and off-site activities are conducted.
EC3	The supervisor uses a variety of information to regularly review and assess the safety and soundness of banks, the evaluation of material risks, and the identification of necessary

	<p>corrective actions and supervisory actions. This includes information, such as prudential reports, statistical returns, information on a bank's related entities, and publicly available information. The supervisor determines that information provided by banks is reliable¹⁸ and obtains, as necessary, additional information on the banks and their related entities.</p>
<p>Description and findings re EC3</p>	<p>The FSD uses a wide range of information while conducting its supervision. It includes prudential and other statistical reports as described more fully in CP 8. EC. 5, as well as information on affiliated parties, information from the credit registry, and other publicly available information (such as news, banks' web sites). If necessary, the CBA may change the periodicity of submission of the reports, as well as require additional reports and/or information.</p> <p>The CBA conducts validity checks on all submitted regulatory reports. Potential anomalies are discussed with banks. Supervisors use regulatory reports in the course of their on-site and off-site activities which serves as a check on the reliability of submitted reports. Also, as a part of thematic reviews by risk teams, data from regulatory reports is analyzed and reviewed for accuracy.</p>
<p>EC4</p>	<p>The supervisor uses a variety of tools to regularly review and assess the safety and soundness of banks and the banking system, such as:</p> <ul style="list-style-type: none"> (a) analysis of financial statements and accounts; (b) business model analysis; (c) horizontal peer reviews; (d) review of the outcome of stress tests undertaken by the bank; and (e) analysis of corporate governance, including risk management and internal control systems. <p>The supervisor communicates its findings to the bank as appropriate and requires the bank to take action to mitigate any particular vulnerabilities that have the potential to affect its safety and soundness. The supervisor uses its analysis to determine follow-up work required, if any.</p>
<p>Description and findings re EC4</p>	<p>These requirements are integrated into the process for conducting risk-based supervision.</p> <ul style="list-style-type: none"> (a) Financial statements and accounts are reviewed regularly, both through on-site inspections and submitted reports as part of the on-going program for identifying and assessing material operations in banks and changes in conditions or risk profiles. (b) Business models are reviewed as part of the identification of material operations and through the annual review of strategic plan submissions by banks. (c) Horizontal peer reviews, or thematic reviews have been conducted to analyze consumer pricing models, restructured loan practices, banks' strategic planning and develop a baseline understanding of practices for market, liquidity, and operational risk. Other reviews have looked at inherent risk in ML/TF risk, corporate governance, and reporting accuracy. (d) Outcomes of bank run stress tests are reviewed quarterly and must address credit, FX, interest rate, price, liquidity and contagion risk. (e) Corporate Governance, including risk management and internal control systems are reviewed as part of the process of measuring "net risk" for material operations. <p>Communication with banks takes the form of written reports and/or meetings with management to review findings and agree upon corrective steps.</p> <p>See CP 14. Corporate Governance and CP 15 Risk management process for additional comments.</p>

¹⁸ Please refer to Principle 10.

EC5	The supervisor, in conjunction with other relevant authorities, seeks to identify, assess and mitigate any emerging risks across banks and to the banking system as a whole, potentially including conducting supervisory stress tests (on individual banks or system-wide). The supervisor communicates its findings as appropriate to either banks or the industry and requires banks to take action to mitigate any particular vulnerabilities that have the potential to affect the stability of the banking system, where appropriate. The supervisor uses its analysis to determine follow-up work required, if any.
Description and findings re EC5	<p>On a regular basis, the CBA conducts stress-tests, both system-wide and for individual firms. The stress-tests are conducted by FSSDD and the results are shared with FSD. The FSSDD conducts macro-prudential analysis, taking into consideration any existing and/or potential economic downturns, which can affect the stability and solvency of individual banks or the banking sector as a whole. If necessary, the supervisor contacts the bank to share his/her concerns and requires taking respective measures. Planning of banks' inspection is based also, inter alia, on the results of the stress-tests and analyses.</p> <p>These stress test practices are credited with supporting the CBAs decision in 2014 to increase minimum capital requirements.</p>
EC6	The supervisor evaluates the work of the bank's internal audit function, and determines whether, and to what extent, it may rely on the internal auditors' work to identify areas of potential risk.
Description and findings re EC6	<p>The RBS manual provides guidance for a comprehensive assessment of a bank's internal audit function. The program elements assessed include:</p> <ul style="list-style-type: none"> • Internal audit rights and responsibilities • Organizational structure • Resources • Planning • Audit performance • Reporting • Quality assurance • Documentation <p>Before transitioning to the RBS approach, the work done by internal audit was reviewed by supervisors at least annually within the scope of annual analysis of the banks' activities. In this review, supervisors required and reviewed the internal audit plan, audit reports on areas examined by internal audit, the minutes of the meetings of the board and audit committee where these reports were discussed, as well as the documentation on the follow-up actions. Supervisors also had meetings and discussions with the members of internal audit in this process.</p> <p>After transitioning to the new supervisory approach, the quality of internal audit is assessed in the risk management part of the Matrix (main supervisory tool). In this context the assessment is reviewed at least annually, the review process includes all the procedures described in the paragraph above, in addition a risk-based approach is used (the supervisors focus on the work done by internal audit with regard to bank's significant activities).</p> <p>In addition to standard annual meetings, the frequency of meetings with internal audit varies from bank to bank depending on the complexity of activities and risk profile of the bank.</p> <p>During on-site examinations/ reviews supervisors usually have meetings with the members of internal audit. In fact, supervisors have at least 2-3 meetings with the members of internal audit during the year.</p>

	It should also be mentioned that usually after on-site inspections supervisors suggest the internal auditors to undertake follow-ups on the recommendations given by the supervisors, and afterwards supervisors have meetings with internal audit to discuss the progress of implementing these recommendations.
EC7	The supervisor maintains sufficiently frequent contacts as appropriate with the bank's board, non-executive Board members, and senior and middle management (including heads of individual business units and control functions) to develop an understanding of and assess matters such as strategy, group structure, corporate governance, performance, capital adequacy, liquidity, asset quality, risk management systems and internal controls. Where necessary, the supervisor challenges the bank's Board and senior management on the assumptions made in setting strategies and business models.
Description and findings re EC7	<p>Board of Directors: During inspections, CBA supervisors always participate in Board meetings held during the inspection period. Supervisors are informed of the Board meeting beforehand, and the agenda and accompanying materials are shared with the inspection team in advance. In addition, the inspection report and supervisory recommendations/orders/sanctions are shared with the banks' boards. All Board members are non-executive.</p> <p>Potential vulnerabilities at a bank may be identified both as a result of inspection and during off-site supervision. Depending on the severity of vulnerability, the issues can be discussed with respective bank representatives via a meeting or via a formal letter. CBA has a practice of sending annual supervisory letters to the Board and executive managers of all banks (separately) that summarize the main issues and concerns in the bank, and whereby they are asked to propose solutions/action plans to address them accordingly.</p> <p>Senior management, internal audit, risk management function: Interaction with the mentioned levels of management of banks is done on regular and on-going basis (weekly, monthly or quarterly depending on the bank) via calls and/or meetings. Meetings on important issues are scheduled and documented. These meetings/calls are held both for clarifying supervisory concerns, issues or questions, and also for obtaining detailed knowledge of banks' next steps to have a forward-looking view of the banks. The latter are also included in annual supervisory plans, where the frequency of meetings (e.g. monthly, quarterly) with relevant management representatives of banks (e.g. CEO, CRO, CFO, internal audit, etc.) is planned. With regards to the internal audit function, CBA reviews and analyzes annual internal audit plans and their performance and discusses them with the heads of internal audit function in banks.</p> <p>During inspections, supervisors also participate in all committees held at the bank during the inspection period (e.g., Credit Committee, Asset and Liability Committee (ALCO), Executive Committee, etc.). Again, the agenda and materials are distributed to the inspection team in advance.</p> <p>With regard to challenging the bank's Board and senior management on the assumptions made in setting strategies and business models, the FSD requires submission of business plans annually and has enhanced its processes for reviewing those plans, incorporating tests of those plans into supervisory activities, and discussing those plans with management and/or the Board.</p>
EC8	The supervisor communicates to the bank the findings of its on- and off-site supervisory analysis in a timely manner by means of written reports or through discussions or meetings with the bank's management. The supervisor meets with the bank's senior management and the Board to discuss the results of supervisory examinations and the external audits, as appropriate. The supervisor also meets separately with the bank's independent Board members, as necessary.

Description and findings re EC8	<p>Findings and issues identified during the inspection are extensively communicated and discussed with respective representatives of the bank during the inspection. In addition, the head of the inspection team and team members (where necessary) hold at least weekly meetings with the head of the banking supervision division responsible for supervision of the given bank to discuss the inspection progress, questions and issues.</p> <p>During the last week of an inspection, the team organizes a meeting with bank's senior management to briefly discuss the main findings of the inspection, the extent of awareness of those issues by senior management, verify the accuracy of initial findings, as well as agree on the next steps (who is doing what, time-schedule, responsible contact persons, etc.).</p> <p>Within two weeks after the end of the inspection and before sending the inspection report to the bank (when the findings, their causes and effects are finally formulated), the inspection team conducts a pre-closing meeting with the senior management of the bank to discuss the main findings and issues.</p> <p>Within two weeks after the pre-closing meeting, the inspection team must finalize the draft inspection report. It is discussed and agreed with the head of the banking supervision division responsible for supervision of the given bank, as well as heads of the two other bank supervision units, deputy head and head of FSD. The executive director of bank or its deputy shall, within one week of receiving the inspection report, sign it as "The inspection report is acknowledged" and return a copy to the CBA. The bank does have the opportunity to comment on the findings, express its objections both regarding the accuracy of findings and/or proposed recommendations, and/or provide explanations within the stated one-week period.</p> <p>After that the inspection report is submitted to the CBA Board and discussed during the Board meeting, where the bank representatives are also invited.</p>
EC9	<p>The supervisor undertakes appropriate and timely follow-up to check that banks have addressed supervisory concerns or implemented requirements communicated to them. This includes early escalation to the appropriate level of the supervisory authority and to the bank's Board if action points are not addressed in an adequate or timely manner.</p>
Description and findings re EC9	<p>The RBS program requires development of a strategy identifying the proper supervisory activities or interventions needed to follow-up on concerns. This can involve combinations of off-site monitoring via bank submitted reporting, or the conduct of targeted inspections to follow up on concerns. Regular (quarterly/monthly) status reports forwarded to the management of FSD address ongoing progress in remediating concerns.</p> <p>When warranted, supervisors, with the support of the Legal department, prepare supervisory orders/sanctions and recommendations with specific action plans to be taken by the bank. These actions are presented to the management and the Board. The action plan is the main document for the follow-up by the supervisor. Depending on the nature of actions required from the bank, the follow-up can be accomplished either via off-site supervision (e.g., review of new policies, provision for specific loans, etc.) or via on-site inspections (as a follow-up inspection).</p> <p>In cases where the bank has failed to comply with the action plan, the Central Bank may apply further sanctions against the bank, in accordance with the LBB.</p>
EC10	<p>The supervisor requires banks to notify it in advance of any substantive changes in their activities, structure and overall condition, or as soon as they become aware of any material adverse developments, including breach of legal or prudential requirements.</p>

Description and findings re EC10	Regulation 3 requires banks to submit a report to the Central Bank on material changes and adverse developments. The report should be submitted as soon as such cases occur, as well as on a quarterly basis.
EC11	The supervisor may make use of independent third parties, such as auditors, provided there is a clear and detailed mandate for the work. However, the supervisor cannot outsource its prudential responsibilities to third parties. When using third parties, the supervisor assesses whether the output can be relied upon to the degree intended and takes into consideration the biases that may influence third parties.
Description and findings re EC11	The CBA is prohibited from outsourcing its prudential responsibilities and, therefore, does not make use of independent third parties to conduct supervision work.
EC12	The supervisor has an adequate information system which facilitates the processing, monitoring and analysis of prudential information. The system aids the identification of areas requiring follow-up action.
Description and findings re EC12	<p>The CBA has systems in place to support the analysis and monitoring of prudential information. Supervisors have access to a system that monitors over 200 key risk and prudential standards indicators for each bank. The system provides user friendly tools to exhibit trend and comparative analysis, flag non-compliance with required standards, and prepare customized peer groupings.</p> <p>The CBA currently is using a system of shared drives across the department to store documents from the newly adopted RBS approach and to permit sharing of information across teams with institutional responsibilities and those with risk specific responsibilities. However, CBA managers are developing plans to build a specific application to better facilitate the RBS program.</p> <p>Regulatory reports from the banks are submitted through a special information system (CBA-Net), which also facilitates the monitoring and analyzing of the financial position of the banks. The FSD collects all internal regulations of banks (both newly adopted and those amended) and has developed a user-friendly internal database to easily search and find the necessary internal acts of a bank.</p>
Additional Criteria	
AC1	The supervisor has a framework for periodic independent review, for example by an internal audit function or third-party assessor, of the adequacy and effectiveness of the range of its available supervisory tools and their use and makes changes as appropriate.
Description and findings re AC1	The internal audit unit of the Central Bank conducts periodic assessment of the supervisory process of the Central Bank, including the capacity and adequacy of supervisory resources and available tools. If necessary, changes are agreed and made.
Assessment of Principle 9	Largely Compliant
Comments	<p>The RBS program was declared operational in December 2017, after piloting the program for five banks in 2016 and adding the remaining twelve banks in 2017. However, a rather limited number of prudential inspections were performed in 2016 (4) and 2017 (7) owing in part to preparing for the transition of twelve banks to the program last year. The transition required significant training to adapt to new procedures and prepare initial risk assessments and supervisory planning products. The supervisory plans currently in place for 2018 contemplate over 40 supervisory activities spread across all 17 banks in the system. It is recommended that the CBA continue to build upon its risk assessment and planning process to ensure a better balance of on-site and off-site activities.</p> <p>Assessors reviewed a sample of risk assessment matrices and it appeared supervisors have significant information gaps. For three firms we reviewed, the risk assessment matrices for</p>

	each were marked as “Incomplete” regarding the assessment of certain management and control mitigants. CBA managers explained that matrices in 2017 were based on last available on-site inspection reports (where feasible), off-site information and other information drawn from frequent meetings and calls with banks. Since this did not fully cover the new requirements, and in particular with respect to QRM assessments, information gaps naturally arose which are being addressed in annual supervisory plans. It is recommended that information gaps identified as part of the initial risk assessment process (2017) for the majority of banks be addressed in the supervisory plans for 2018-2019.
Principle 10	Supervisory reporting. The supervisor collects, reviews and analyses prudential reports and statistical returns¹⁹ from banks on both a solo and a consolidated basis, and independently verifies these reports through either on-site examinations or use of external experts.
Essential Criteria	
EC1	The supervisor has the power ²⁰ to require banks to submit information, on both a solo and a consolidated basis, on their financial condition, performance, and risks, on demand and at regular intervals. These reports provide information such as on and off-balance sheet assets and liabilities, profit and loss, capital adequacy, liquidity, large exposures, risk concentrations (including by economic sector, geography and currency), asset quality, loan loss provisioning, related party transactions, interest rate risk, and market risk.
Description and findings re EC1	Regulation 3 sets out the types and frequency of supervisory reports to be submitted by the banks. In terms of frequency, reports shall be submitted daily, weekly, monthly, quarterly and annually. The reports provide information on balance sheets (including on and off items,) profit and loss, liquidity, asset quality and provisioning, large exposure, asset concentrations, etc. These reports form the basis for off-site supervision activities. The regulation also provides for the submission of ad hoc reports at the request of the supervisor. Furthermore, Regulation/20/03 requires consolidated reporting for financial groups. It was observed that there is no detailed reporting on restructured loans. CBA staff indicated they are drafting a new report for this purpose. Banks also submit their annual financial statements, certified by the external auditor, as well as quarterly financial statements.
EC2	The supervisor provides reporting instructions that clearly describe the accounting standards to be used in preparing supervisory reports. Such standards are based on accounting principles and rules that are widely accepted internationally.
Description and findings re EC2	Article 4 of the Law on Accounting provides that the regulation of accounting in banks is executed by the CBA in coordination with the relevant account setting body in Armenia. According to Article 3 of the Law on Accounting, banks prepare their reports based on IFRS.
EC3	The supervisor requires banks to have sound governance structures and control processes for methodologies that produce valuations. The measurement of fair values maximizes the use of relevant and reliable inputs and is consistently applied for risk management and reporting purposes. The valuation framework and control procedures are subject to adequate independent validation and verification, either internally or by an external expert. The supervisor assesses whether valuation used for regulatory purposes is reliable and

¹⁹ In the context of this Principle, “prudential reports and statistical returns” are distinct from and in addition to required accounting reports. The former is addressed by this Principle, and the latter are addressed in Principle 27.

²⁰ Please refer to Principle 2.

	prudent. Where the supervisor determines that valuations are not sufficiently prudent, the supervisor requires the bank to make adjustments to its reporting for capital adequacy or regulatory reporting purposes.
Description and findings re EC3	<p>According to the Law on Accounting, banks are required to comply with IFRSs. During its on-going supervision, the Central Bank makes sure that banks have sound processes and structures to comply with all the requirements of IFRS, including the methodology for valuations. When determining any issues, the supervisor may require the bank to make respective adjustments.</p> <p>Valuation used for regulatory purposes is straightforward as most of the assets are measured at amortized cost, while fair value measurement (either through other comprehensive income or profit/loss) is mainly limited to government securities, valuation of which is based on yield curve provided by the CBA. Moreover, published (annual) financial reports of banks are subject to mandatory external audit by independent auditors. The latter perform their audit in accordance with IFRS standards, including checking the prudence of any valuation methodologies used (also for real estate and collateral).</p>
EC4	The supervisor collects and analyses information from banks at a frequency commensurate with the nature of the information requested, and the risk profile and systemic importance of the bank.
Description and findings re EC4	All banks, irrespective of their size, activities and risk profile, must submit the same information at the same frequency as described in EC 1. Regulation 3 provides that the CBA may require banks to submit further information, in addition to that which they submit on a regular basis. Supervisors frequently request ad-hoc information for various supervisory purposes, and in most cases such information is required from large banks or banks with higher risk profiles.
EC5	In order to make meaningful comparisons between banks and banking groups, the supervisor collects data from all banks and all relevant entities covered by consolidated supervision on a comparable basis and related to the same dates (stock data) and periods (flow data).
Description and findings re EC5	Reports are collected from all banks for the same dates and periods to allow the CBA to make meaningful comparisons among banks and banking groups.
EC6	The supervisor has the power to request and receive any relevant information from banks, as well as any entities in the wider group, irrespective of their activities, where the supervisor believes that it is material to the condition of the bank or banking group, or to the assessment of the risks of the bank or banking group or is needed to support resolution planning. This includes internal management information.
Description and findings re EC6	The CBA has authority under Regulation 20/03, Chapter 9 to request additional information and explanations from financial group on parts of the reports, which need further explanation and clarification, as well as additional information and clarifications for specific supervisory purposes. CBA staff report having no difficulty in receiving all necessary information at any time from banks and banking groups. Regulation 3 provides the CBA authority to require banks to submit further information, in addition to that which they submit on a regular basis.
EC7	The supervisor has the power to access ²¹ all bank records for the furtherance of supervisory work. The supervisor also has similar access to the bank's Board, management and staff, when required.

²¹ Please refer to Principle 1, Essential Criterion 5.

Description and findings re EC7	In accordance with Article 57 of the LBB, the CBA has full access to all banks' records for the purpose of carrying out its supervisory function. It also has full access to the banks' boards, management and staff.
EC8	The supervisor has a means of enforcing compliance with the requirement that the information be submitted on a timely and accurate basis. The supervisor determines that an appropriate level of the bank's senior management is responsible for the accuracy of supervisory returns, imposes sanctions for misreporting and persistent errors, and requires that inaccurate information be amended.
Description and findings re EC8	Regulation 3 provides that the banks provide the CBA with reports on a timely and accurate basis. Articles 11 and 12 of the Law on Accounting provide that the supervisor has the authority to hold management responsible for accurate and reliable record keeping and for publishing (quarterly and annual) financial information. The supervisor ensures that the appropriate level of senior management is responsible for the accuracy of the reports. Article 63 of the LBB permits the CBA to impose penalties for misreporting and errors in reports and also to amend inaccurate information.
EC9	The supervisor utilizes policies and procedures to determine the validity and integrity of supervisory information. This includes a program for the periodic verification of supervisory returns by means either of the supervisor's own staff or of external experts. ²²
Description and findings re EC9	The validity and integrity of supervisory information is confirmed via the on-site inspection regime and off-site analysis (e.g., via cross-checking of reports, identification of large deviations, etc.). Further, a thematic inspection of the accuracy of certain reports submitted to the CBA is currently in process. Also, under Article 58 of the LBB, the external auditors must include a review of the validity of the regulatory reports as part of their audit function.
EC10	The supervisor clearly defines and documents the roles and responsibilities of external experts, ²³ including the scope of the work, when they are appointed to conduct supervisory tasks. The supervisor assesses the suitability of experts for the designated tasks(s) and the quality of the work and takes into consideration conflicts of interest that could influence the output/recommendations by external experts. External experts may be utilized for routine validation or to examine specific aspects of banks' operations.
Description and findings re EC10	The CBA is prohibited from outsourcing its prudential responsibilities and, therefore, does not make use of independent third parties to conduct supervision work.
EC11	The supervisor requires that external experts bring to its attention promptly any material shortcomings identified during the course of any work undertaken by them for supervisory purposes.
Description and findings re EC11	See EC 10.
EC12	The supervisor has a process in place to periodically review the information collected to determine that it satisfies a supervisory need.
Description and findings re EC12	The CBA is frequently revising its reports to meet supervisory needs; however, there is no requirement for a periodic review of all reports to determine they are satisfying a supervisory need.

²² Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

²³ Maybe external auditors or other qualified external parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions. External experts may conduct reviews used by the supervisor, yet it is ultimately the supervisor that must be satisfied with the results of the reviews conducted by such external experts.

Assessment re Principle 10	Compliant
	There is no requirement for a periodic review of all reports to determine they are satisfying a supervisory need. It is recommended that periodically (every five years), the CBA review each of its supervisory reports to determine it is still meeting a supervisory need.
Principle 11	Corrective and sanctioning powers of supervisors. The supervisor acts at an early stage to address unsafe and unsound practices or activities that could pose risks to banks or to the banking system. The supervisor has at its disposal and adequate range of supervisory tools to bring about timely corrective actions. This includes the ability to revoke the banking license or to recommend its revocation.
EC1	The supervisor raises supervisory concerns with the bank's management or, where appropriate, the bank's Board, at an early stage, and requires that these concerns be addressed in a timely manner. Where the supervisor requires the bank to take significant corrective actions, these are addressed in a written document to the bank's Board. The supervisor requires the bank to submit regular written progress reports and checks that corrective actions are completed satisfactorily. The supervisor follows through conclusively and in a timely manner on matters that are identified.
Description and findings re EC1	Where issues of concern become known to the CBA during the off-site or on-site monitoring process, these concerns are raised with the management or the Board of the banks. Article 61 of the LBB states that CBA may apply sanctions against banks and managers in case of infringements detailed in art. 60 and 60.1. On an on-going basis, depending on the severity of the breach, examiners contact their correspondents in the banks at an early stage. FSD also sends annual supervisory letters to the Board and executive managers of each bank separately, where the main issues and concerns that have been identified by supervisors are summarized, and whereby banks are requested to propose solutions/action plans to address them accordingly. Progress reports are required from banks on the actions required and the CBA checks that the remedial action is satisfactory, as assessors have been able to verify.
EC2	The supervisor has available ²⁴ an appropriate range of supervisory tools for use when, in the supervisor's judgement, a bank is not complying with laws, regulations or supervisory actions, is engaged in unsafe or unsound practices or in activities that could pose risks to the bank or the banking system, or when the interests of depositors are otherwise threatened.
Description and findings re EC2	Based on grounds specified in article 60 of LBB and according to article 61 of LBB, the Central Bank may apply sanctions to banks, as follows: a) warning and directive to eliminate infringements; b) fine; c) deprivation of bank managers' qualification certificate, and d) nullification of the license (see also EC 4 below).
EC3	The supervisor has the power to act where a bank falls below established regulatory threshold requirements, including prescribed regulatory ratios or measurements. The supervisor also has the power to intervene at an early stage to require a bank to take action to prevent it from reaching its regulatory threshold requirements. The supervisor has a range of options to address such scenarios.
Description and findings re EC3	See EC 1 and EC 2. In addition to Articles 60 and 61 of the LBB, if in the opinion of the Central Bank, a bank has undertaken activities that can hinder the interests of its depositors or other creditors, the CBA may apply sanctions. Banks are required to maintain adequate capital and liquidity at all times at both controlling company and individual bank levels. Should a bank or banking group fall below the set requirements, the CBA may intervene to

²⁴ Please refer to Principle 1.

	<p>remedy the shortfall. However, there is no formal Prompt Corrective Action (PCA) framework.</p> <p>Appropriate enforcement actions can be taken based on supervisory judgments for the purposes of ensuring the stability of the banking system, and the Central Bank may establish in specific cases more stringent prudential standards for a specific period of time. A number of fines have been imposed on several banks in the last 5 years, but no fines on managers, nor revocation of manager's professional certificates, nor temporary suspension of a bank's license have been issued.</p>
EC4	<p>The supervisor has available a broad range of possible measures to address, at an early stage, such scenarios as described in essential criterion 2 above. These measures include the ability to require a bank to take timely corrective action or to impose sanctions expeditiously. In practice, the range of measures is applied in accordance with the gravity of a situation.</p> <p>The supervisor provides clear prudential objectives or sets out the actions to be taken, which may include restricting the current activities of the bank, imposing more stringent prudential limits and requirements, withholding approval of new activities or acquisitions, restricting or suspending payments to shareholders or share repurchases, restricting asset transfers, barring individuals from the banking sector, replacing or restricting the powers of managers, Board members or controlling owners, facilitating a takeover by or merger with a healthier institution, providing for the interim management of the bank, and revoking or recommending the revocation of the banking license.</p>
Description and findings re EC4	<p>In addition to the administrative sanctions referred to in art. 61 of LBB, the CBA can impose restrictions on the activities ("lending, deposits, financial operations, certain types of investments") of the bank if it believes that the bank is being run without due regard to risk (LBB, art.41). Article 22 of the LBB and Chapter 28 of Regulation 1 authorize the CBA to remove board members and senior management where they fail to continue to meet the relevant criteria for the appointments to their positions or where their actions lead to a deterioration of the bank's performance or harm its reputation (see also CP1, EC6).</p> <p>According to the Manual on sanctions applied by CBA against banks, the violations are differentiated into non-significant and significant violations. Considered significant are those violations that are related to violations of regulatory capital, prudential ratios, instances of hindrance to supervision, and any other violations which undermine or may undermine the interests of bank customers, depositors and other creditors, or which leads to or may lead to significant deterioration in the financial standing of the bank, or its reputation. Non-significant violations include errors in reports submitted to the CBA, inappropriate accounting recordings, insignificant errors in published financial reports of the bank, etc. Supervisors may, however, use their judgment to re-classify a violation from significant to insignificant and vice versa, according to the established procedure. Non-significant violations are provided to the bank in a written form in the name of the head of the FSD, whereas for significant violations recorded by the supervisors an administrative supervisory proceeding is initiated by the office of the Chairman of the CBA. In order to ensure full transparency, the bank is invited to a session of the Licensing and Supervision Committee where the handling of violations of the banking law and regulations are discussed.</p>
EC5	<p>The supervisor applies sanctions not only to the bank but, when and if necessary, also to management and/or the Board, or individuals therein.</p>
Description and findings re EC5	<p>Article 63 (5) allows the CBA to impose a fine on bank managers, individually and collectively, where their actions have exposed the bank to unjustifiable risk. This has not occurred in the last 5 years.</p>

EC6	The supervisor has the power to take corrective actions, including ring-fencing of the bank from the actions of parent companies, subsidiaries, parallel-owned banking structures and other related entities in matters that could impair the safety and soundness of the bank or the banking system.
Description and findings re EC6	Article 41 of the LLB provides that the CBA may provide limitations or special rules of procedure on lending, deposit taking, financial operations, investments to reduce undue risk in a bank. Articles 39.20 and 39.21 of the LCB provide CBA with the powers to impose restrictions on banks that are members of financial groups.
EC7	The supervisor cooperates and collaborates with relevant authorities in deciding when and how to initiate the orderly resolution of a problem bank situation (which could include closure, or assisting in restructuring, or merger with a stronger institution).
Description and findings re EC7	The CBA is the resolution authority. Article 2 of the Law on Bankruptcy specifies that the CBA shall consider a bank insolvent “if (i) its capital is exhausted to 50 per cent of its minimum required level; or (ii) the bank is unable to meet the legitimate claims of its creditors, or (iii) the aggregated evaluation of indicators of the bank is below the threshold of aggregated evaluation of indicators established by the Board of the Central Bank, or (iv) the bank regularly violates the norm of mandatory reserve provided for by the law”. Once any of these events happens, the CBA shall, within a two-week period, appoint a provisional administrator and approve the program of financial rehabilitation or file bankruptcy procedures with the court. The provisional administrator will assume full responsibility for the running of the bank.
Additional criteria	
AC1	Laws or regulations guard against the supervisor unduly delaying appropriate corrective actions.
Description and findings re AC1	There are no safeguards in the legal and regulatory framework that would prevent from such delays. In case of resolution, due to the court-based system currently in place, it could possibly delay resolution and possibly repayment of insured depositors, risking contagion and deposit runs at other banks. However, the repayment of insured deposits may start immediately after the insolvency of the bank without the court decision (Article 5 of the Law on DGF).
AC2	When taking formal corrective action in relation to a bank, the supervisor informs the supervisor of non-bank related financial entities of its action and, where appropriate, coordinates its actions with them.
Description and findings re AC2	The CBA is the sole regulator and supervisor in Armenia. Information is shared among the department in charge of banks and non-banks entities.
Assessment re Principle 11	Largely Compliant
Comments	The laws and regulations provide the CBA with sufficient tools to address unsafe and unsound practices within a bank or banking group in a timely fashion. Evidence was cited of actions taken by the supervisory authority in the recent past. CBA would benefit however, from elaborating a detailed Prompt Corrective Action framework and disclosing it to all stakeholders. A Prompt Corrective Action Regulation would clearly prescribe mandatory and discretionary supervisory actions to be taken when an institution breaches specified capital thresholds and triggers. The corrective action framework should be reviewed with a view to facilitating the decision to trigger and achieve an orderly resolution. Revisiting the current resolution framework to allow the CBA to develop a regime specifically dedicated to banks resolution in line with the Key attributes of the FSB should be helpful in this regard.

	An inconsistency in the application of sanctions for all large exposure breaches is discussed more fully under CP 19.
Principle 12	Consolidated supervision. An essential element of banking supervision is that the supervisor supervises the banking group on a consolidated basis, adequately monitoring and, as appropriate, applying prudential standards to all aspects of the business conducted by the banking group worldwide.²⁵
Essential criteria	
EC1	The supervisor understands the overall structure of the banking group and is familiar with all the material activities (including non-banking activities) conducted by entities in the wider group, both domestic and cross-border. The supervisor understands and assesses how group-wide risks are managed and takes action when risks arising from the banking group and other entities in the wider group, in particular contagion and reputation risks, may jeopardize the safety and soundness of the bank and the banking system.
Description and findings re EC1	<p>In 2015 amendments to LCB were adopted, specifically in Chapter 5.2. According to these changes, the term “financial group” was defined, and powers were given to CBA to exercise consolidated supervision. In 2016, the CBA board introduced Regulations 20/01, 20/02, 20/03, and 20/4 regarding the consolidated supervision framework. These include procedures for group identification, prudential standards, reporting, internal control requirements, etc. Furthermore, a consolidated supervision manual was approved in October 2017 to compliment the RBS manual. It describes risks that must be assessed for the group including contagion and reputation risks.</p> <p>A financial group is defined as two or more affiliated financial organizations and the parent organization exercising control as established under IFRS 10. A financial organization is defined as a bank, credit organization, investment company, investment fund manager, or insurance company. The CBA has the power to regulate and supervise all members of the group, including the establishment of prudential standards. With regard to any companies identified as direct or indirect interests of the ownership, but not included in the financial group, the CBA requires financial information on their activities, including transactions with the financial group. Under Article 39(21), the CBA may require termination of a shareholder’s interest in the financial group if they believe that the shareholder or his outside interests may cause undue risks for the financial group or its customers.</p> <p>Currently, there are four financial groups identified; three of which have small insurance affiliates, and one has a credit extending affiliate. None are considered not low risk, and none have cross-border operations. The risk assessment is revalidated annually. According to Regulation 20/01, CBA classifies groups as not low or low risk based on their riskiness and impact on financial system and/or economy. More specific criteria for defining high risk groups are established in the manual on consolidated supervision, summarized as follows: (1) impact on financial stability, (2) threats to consumer protections, (3) asset size, (4) complexity of group and riskiness of individual entities of the group, (5) size, nature and riskiness of intergroup transactions, (6) reputational and contagion risk specifically, and (7) and supervisory arbitrage possibilities Groups that are not considered high risk are not subject to prudential standards for groups, although the banks are subject to prudential standards on a solo basis. For these banks, supervisors apply the RBS program described more fully under CP 8.</p> <p>Regulation 1 requires banks to submit details on affiliates of shareholders (both natural and legal) on an annual basis. Regulation 20/03 defines the information to be received</p>

²⁵ Please refer to footnote 19 under Principle 1.

	<p>from financial group periodically as well as states that the CBA may request any additional information for supervisory purposes.</p> <p>Furthermore, under Article 28 of LBB, the CBA might not give its consent for an Armenian bank to establish a branch outside of Armenia if the CBA is not satisfied with the regulatory arrangements in that other jurisdiction or if the CBA is not allowed to properly supervise the overseas operations. Under Article 41 of the LBB, the CBA has the power to restrain the activities of a bank and its subsidiaries. Articles 39.20 and 39.21 of LCB provide CBA the power to limit intra-group transactions and change the structure of the financial group.</p>
EC2	The supervisor imposes prudential standards and collects and analyses financial and other information on a consolidated basis for the banking group, covering areas such as capital adequacy, liquidity, large exposures, and exposures to related parties, lending limits and group structure.
Description and findings re EC2	<p>Articles 39.19 and 39.20 of Law on "Central Bank of Armenia" enable CBA to impose prudential standards on financial groups, as well as to require information (including, but not limited to financial reports) about its activities. Regulation 20/02 imposes prudential standards for high risk groups. High risk banking groups, specifically, are required to calculate all prudential ratios described in Regulation 2 on consolidated basis (except for reserve requirements and foreign currency disposition standards), as well as intragroup transactions limit if required by the supervisor. According to Regulation 20/03, responsible entity provides CBA with reports on prudential ratios.</p> <p>As indicated under EC 1, no groups are currently identified as high risk.</p>
EC3	The supervisor reviews whether the oversight of a bank's foreign operations by management (of the parent bank or head office and, where relevant, the holding company) is adequate having regard to their risk profile and systemic importance and there is no hindrance in host countries for the parent bank to have access to all the material information from their foreign branches and subsidiaries. The supervisor also determines that banks' policies and processes require the local management of any cross-border operations to have the necessary expertise to manage those operations in a safe and sound manner, and in compliance with supervisory and regulatory requirements. The home supervisor takes into account the effectiveness of supervision conducted in the host countries in which its banks have material operations.
Description and findings re EC3	Under Article 28 of the LBB, all banks require the permission of the CBA to establish foreign branches and subsidiaries. Currently, no Armenian bank has a foreign subsidiary or branch.
EC4	The home supervisor visits the foreign offices periodically, the location and frequency being determined by the risk profile and systemic importance of the foreign operation. The supervisor meets the host supervisors during these visits. The supervisor has a policy for assessing whether it needs to conduct on-site examinations of a bank's foreign operations or require additional reporting and has the power and resources to take those steps as and when appropriate.
Description and findings re EC4	No Armenian bank has a foreign subsidiary. Central Bank of Armenia is a host supervisor.
EC5	The supervisor reviews the main activities of parent companies, and of companies affiliated with the parent companies, that have a material impact on the safety and soundness of the bank and the banking group and takes appropriate supervisory action.
Description and findings re EC5	The CBA has the power to review the activities of all significant shareholders (including parent companies) at application stage. As for review on an ongoing basis, the supervisors periodically receive information on entities related to the bank and include their

	assessments of all significant shareholders in their annual reports. In addition, if the structure of its shareholders changes, banks are required to notify the CBA.
EC6	The supervisor limits the range of activities the consolidated group may conduct and the locations in which activities can be conducted (including the closing of foreign offices) if it determines that: <ul style="list-style-type: none"> (a) the safety and soundness of the bank and banking group is compromised because the activities expose the bank or banking group to excessive risk and/or are not properly managed; (b) the supervision by other supervisors is not adequate relative to the risks the activities present; and/or (c) the exercise of effective supervision on a consolidated basis is hindered.
Description and findings re EC6	According to Article 39.21 of the LCB, the CBA has the power to change the structure of financial group if the Central Bank believes that this structure poses risks to the financial group and/or undermines interests of the clients (consumers) or imposes obstacles for efficient supervision. In addition, Article 41 of the LBB allows the CBA to place limitations on the activities of a bank if it believes that the actions of the bank are putting it at risk. Under Regulation 20/02, CBA can restrict intragroup transactions.
EC7	In addition to supervising on a consolidated basis, the responsible supervisor supervises individual banks in the group. The responsible supervisor supervises each bank on a stand-alone basis and understands its relationship with other members of the group. ²⁶
Description and findings re EC7	The CBA is the mega-regulator of the financial system in Armenia, so it supervises financial institutions on both a solo and consolidated basis.
Additional criteria	
AC1	For countries, which allow corporate ownership of banks, the supervisor has the power to establish and enforce fit and proper standards for owners and senior management of parent companies.
Description and findings re AC1	According to Regulation 1, to receive the preliminary consent for bank acquisition, information on the financial situation, the owners and management and other information about the company should be provided to the CBA.
Assessment of Principle 12	Compliant
Comments	The CBA issued new regulations since the previous assessment to address consolidated supervision.
Principle 13	Home-host relationships. Home and host supervisors of cross-border banking groups share information and cooperate for effective supervision of the group and group entities, and effective handling of crisis situations. Supervisors require the local operations of foreign banks to be conducted to the same standards as those required of domestic banks.
Essential criteria	
EC1	The home supervisor establishes bank-specific supervisory colleges for banking groups with material cross-border operations to enhance its effective oversight, taking into account the risk profile and systemic importance of the banking group and the corresponding needs of its supervisors. In its broadest sense, the host supervisor who has a relevant subsidiary or a significant branch in its jurisdiction and who, therefore, has a shared interest in the effective supervisory oversight of the banking group, is included in

²⁶ Please refer to Principle 16, Additional Criterion 2.

	the college. The structure of the college reflects the nature of the banking group and the needs of its supervisors.
Description and findings re EC1	<p>Currently, no Armenian bank has a foreign branch or foreign subsidiary, hence the CBA is not a home supervisor and does not establish any supervisory colleges.</p> <p>There are four foreign banks with subsidiaries in Armenia for which the CBA acts as a host supervisor. As all of the foreign owned bank subsidiaries in Armenia are small relative to their parent bank, the CBAs participation in supervisory colleges is limited to just two banks.</p>
EC2	Home and host supervisors share appropriate information on a timely basis in line with their respective roles and responsibilities, both bilaterally and through colleges. This includes information both on the material risks and risk management practices of the banking group ²⁷ and the supervisors' assessments of the safety and soundness of the relevant entity under their jurisdiction. Informal or formal arrangements (such as memoranda of understanding) are in place to enable the exchange of confidential information.
Description and findings re EC2	<p>The CBA reports that home supervisors do not request any information regarding their Armenian subsidiaries given the size and impact of the subsidiary relative to the parent bank, although these subsidiaries are consolidated in the financial statements of the foreign parent.</p> <p>In its capacity as host supervisor, the CBA conducts supervision of foreign owned banks much the same as for domestic banks. All foreign banks operate in subsidiary form; branching is not permitted. While supervisors do not regularly request information from foreign supervisors, there has been coordination in one problem bank situation where managers from the parent bank became more active. As foreign bank subsidiaries seek to use risk management systems or models within the parent company (e.g., retail credit scoring models), the need for coordination will likely increase.</p> <p>MOUs are in place with all home supervisors except one who declined a request to enter into an agreement but committed to evaluate requests for information individually. Should the need for information sharing arise, regulations facilitate the sharing of information with or without formal arrangements. Article 8 of the LCB provides that the CBA may share or receive information from foreign supervisory authorities, without an international agreement or MOU.</p>
EC3	Home and host supervisors coordinate and plan supervisory activities or undertake collaborative work if common areas of interest are identified in order to improve the effectiveness and efficiency of supervision of cross-border banking groups.
Description and findings re EC3	As a practical matter, there has been no coordination of supervisory activities relative to cross-border banking groups, although there has been communication on an ad hoc basis.
EC4	The home supervisor develops an agreed communication strategy with the relevant host supervisors. The scope and nature of the strategy reflects the risk profile and systemic importance of the cross-border operations of the bank or banking group. Home and host supervisors also agree on the communication of views and outcomes of joint activities and college meetings to banks, where appropriate, to ensure consistency of messages on group-wide issues.

²⁷ See illustrative example of information exchange in colleges of the October 2010 BCBS Good practice principles on supervisory colleges for further information on the extent of information sharing expected.

Description and findings re EC4	To date, there have been no joint supervisory activities or the need for a coordinated communication strategy.
EC5	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities, develops a framework for cross-border crisis cooperation and coordination among the relevant home and host authorities. The relevant authorities share information on crisis preparations from an early stage in a way that does not materially compromise the prospect of a successful resolution and subject to the application of rules on confidentiality.
Description and findings re EC5	Home supervisors for foreign banks operating in Armenia have not shared plans for cross-border crisis cooperation or coordination given the size and impact of Armenian operations on the parent company.
EC6	Where appropriate, due to the bank's risk profile and systemic importance, the home supervisor, working with its national resolution authorities and relevant host authorities, develops a group resolution plan. The relevant authorities share any Information necessary for the development and maintenance of a credible resolution plan. Supervisors also alert and consult relevant authorities and supervisors (both home and host) promptly when taking any recovery and resolution measures.
Description and findings re EC6	To date there has been no discussion of group resolution plans with home supervisors. However, two foreign banks are of significant size locally and it is recommended the CBA gain an understanding of the resolution framework applicable to these firms in their home jurisdictions and assess the need for a contingency plan for local subsidiaries. MoU's should be amended to specifically address the ability to share information regarding resolution strategies.
EC7	The host supervisor's national laws or regulations require that the cross-border operations of foreign banks are subject to prudential, inspection and regulatory reporting requirements similar to those for domestic banks.
Description and findings re EC7	Foreign bank subsidiaries operate under the same prudential, inspection and regulatory reporting requirements as applicable to domestic banks.
EC8	The home supervisor is given on-site access to local offices and subsidiaries of a banking group in order to facilitate their assessment of the group's safety and soundness and compliance with customer due diligence requirements. The home supervisor informs host supervisors of intended visits to local offices and subsidiaries of banking groups.
Description and findings re EC8	Home supervisors have full access to the operations of their subsidiary banks in Armenia, although existing MOUs require the home supervisor to inform the CBA of on-site visits. To date, there have been no on-site visits.
EC9	The host supervisor supervises booking offices in a manner consistent with internationally agreed standards. The supervisor does not permit shell banks or the continued operation of shell banks.
Description and findings re EC9	There are no shell banks or booking offices in Armenia.
EC10	A supervisor that takes consequential action on the basis of information received from another supervisor consults with that supervisor, to the extent possible, before taking such action.
Description and findings re EC10	No information has been received requiring such actions.

Assessment of Principle 13	Largely Compliant
Comments	To date there has been no discussion of group resolution plans with home supervisors. Considering there are foreign bank subsidiaries of significant size locally it is recommended that the CBA gain an understanding of the resolution framework applicable to these firms in their home jurisdictions. MoU's should be amended to address the ability to share information regarding resolution strategies where feasible.

C. Prudential Regulations Requirements

Principle 14	Corporate governance. The supervisor determines that banks and banking groups have robust corporate governance policies and processes covering, for example, strategic direction, group and organizational structure, control environment, responsibilities of the banks' Boards and senior management,²⁸ and compensation. These policies and processes are commensurate with the risk profile and systemic importance of the bank.
Essential criteria	
EC1	Laws, regulations or the supervisor establish the responsibilities of a bank's Board and senior management with respect to corporate governance to ensure there is effective control over the bank's entire business. The supervisor provides guidance to banks and banking groups on expectations for sound corporate governance.
Description and findings re EC1	<p>Apart from the general corporate legislation represented by the Law of RA on Joint Stock Companies, important rules and regulations regarding bank corporate governance are included in the LBB. This law specifies the main governance/decision-making bodies, including the board, their characteristics, decision-making powers and responsibilities, certain procedural aspects of their work, as well as requirements regarding internal audit.</p> <p>For instance, the LBB specifies the minimum and maximum number of board members, requirements regarding formation and composition of the board, and the main decision-making authorities and responsibilities of the board. Authorities and responsibilities of the Executive board are also addressed. The law also covers the designations of Board members to provide oversight to the internal audit, risk management, and compliance functions.</p> <p>Regulation 4 of the CBA on Minimal Conditions of Internal Control in Banks includes requirements on the organizational structure, internal regulatory framework, risk management, compliance and internal audit functions.</p> <p>In addition, the roles and responsibilities of governing bodies with regard to risk management are described in the Credit Risk Management, Liquidity Risk Management and Operational Risk Management Guidelines approved by the CBA.</p> <p>In 2017 the Corporate Governance team within FSD drafted and shared with banks a guideline on strategic planning in banks called "Supervisory expectations on strategic plans and strategic planning process" which also provides certain clarification on the role of the Board and the Executive management in the process of strategic planning.</p> <p>Annex 3 of the RBS Manual specifies principles, guidelines and a rating system to help the supervisors assess various aspects and elements of governance in banks and insurance companies, including Board, Executive management, Internal audit, Risk Management and Compliance functions and operational management (following the 3 lines of defense principle).</p>

²⁸ Please refer to footnote 27 under Principle 5.

EC2	The supervisor regularly assesses a bank's corporate governance policies and practices, and their implementation, and determines that the bank has robust corporate governance policies and processes commensurate with its risk profile and systemic importance. The supervisor requires bank and banking groups to correct deficiencies in a timely manner.
Description and findings re EC2	<p>Until 2016, the majority of on-site inspections had been full-scope inspections, and governance had been one area reviewed in those inspections.</p> <p>After transitioning to the new RBS approach the inspections are mostly targeted. During targeted on-site inspections, governance frameworks are examined in the scope of the area being inspected. For example, in 2016 and 2017 there were inspections on corporate lending process and portfolio quality reviews, risk management reviews in retail lending, etc. which also included the evaluation of the governance framework. Governance topics can also specifically be included in the annual supervisory plans of individual banks. Within FSD, a corporate governance team was created in 2016. This team undertakes thematic reviews on corporate governance topics, develops benchmarks and communicates the results to the supervisors and banks. The team has conducted thematic reviews on Risk Control Functions and the role of the CRO, and strategic planning for banks.</p> <p>During both full-scope and targeted inspections there were governance issues identified that were common in institutions with different types of ownership, and there were also issues linked to particular types of ownership. Deficiencies identified during off-site analysis or on-site inspections are dealt with as violations of laws and regulations or issues/deficiencies to be resolved according to the recommendations given by the supervisor.</p>
EC3	The supervisor determines that governance structures and processes for nominating and appointing Board members are appropriate for the bank and across the banking group. Board membership includes experienced non-executive members, where appropriate. Commensurate with the risk profile and systemic importance, Board structures include audit, risk oversight and remuneration committees with experienced non-executive members.
Description and findings re EC3	<p>Requirements for nominating and appointing Board members are specified under the LBB. These requirements establish a process for shareholders that own 10 percent or more to be represented on the Board. Shareholders holding less than 10 percent can act as a group to gain representation on the Board as well.</p> <p>Appointments to the Board are subject to fit and proper testing and approval by the CBA. As outlined in Regulation 1, the Board member should be well aware of the financial system, laws and regulations on banking, as well as the bank's business plan and internal regulations. Board members must have a high-level education (at least master's degree equivalent) and at least 5 years of professional experience, or 10 years of professional experience with no master's degree. All Board members of banks are non-executive (Article 22 (4)). Furthermore, according to article 21.4 of the LBB, Board members should not be related to each other or members of the executive body</p> <p>In the process of fit & proper testing and approval by the CBA, the Board member candidates also must pass an interview that aims to assess the qualifications of the candidate. In cases when the candidate is a well-known professional, his/her qualifications can be acknowledged without the interview. The topics that should be discussed during the interview are also specified by Regulation 1.</p> <p>Examination guidelines outlined in the RBS manual require examiners to make inquiries and judgments to assess the Board composition and its structure including:</p> <ul style="list-style-type: none"> • The extent to which the composition and structure of the Board ensure the fair and impartial representation of all shareholders;

	<ul style="list-style-type: none"> • Policies regarding Board members selection, appointment, change, succession and independence among them; • The effectiveness of the Board's structure for effective oversight of senior management • The adequacy of the size of the Board and the Board members' qualifications, knowledge, experience and skills; • The ability of the Board to exercise independent, impartial, sound and informed judgment.
EC4	Board members are suitably qualified, effective and exercise their "duty of care" and "duty of loyalty." ²⁹
Description and findings re EC4	Under Regulation 1 the CBA sets qualifying fit and proper requirements for the Board members of the banks. All the Board candidates must pass interviews at the CBA Board before being appointed as Board members of banks. Article 60.1(1) of LBB defines that the bank managers (including Board members) should perform their duties "resting upon bank's interests, they shall perform their rights and obligations towards the bank bona fide and sensibly". During on-site examinations, supervisors assess the performance of Board members, including whether they exercise their "duty of care" and "duty of loyalty."
EC5	The supervisor determines that the bank's Board approves and oversees implementation of the bank's strategic direction, risk appetite ³⁰ and strategy, and related policies, establishes and communicates corporate culture and values (e.g., through a code of conduct), and establishes conflicts of interest policies and a strong control environment.
Description and findings re EC5	<p>Under Article 21.6 of LBB the Board must determine the core activities of the bank, including approval of the strategic plan for development of the bank.</p> <p>Regulation 4 indicates that the Board should set the risk appetite of the Bank, as well as the internal policies regarding the internal control environment.</p> <p>Also, under Regulation 4, the compliance function, established by the Board, should "encourage and support the formation of ethical corporate culture within the bank, which values responsible behavior and compliance of employees' activities with requirements of laws and other legal acts, including the bank's internal policies."</p> <p>Article 17 of Regulation 4 indicates that the internal control system, concerning the bank's organizational structure, at least includes the properly segregated duties and authorities of the bank's divisions and employees. Possible cases and areas of conflicts of interest should be disclosed and controlled.</p> <p>Examination guidelines outlined in the RBS manual require examiners to make inquiries and judgments to assess:</p> <ul style="list-style-type: none"> • The viability of the organizations business model and risk appetite:

²⁹ The OECD (OECD glossary of corporate governance-related terms in "Experiences from the Regional Corporate Governance Roundtables," 2003, www.oecd.org/dataoecd/19/26/23742340.pdf) defines "duty of care" as "The duty of a board member to act on an informed and prudent basis in decisions with respect to the company. Often interpreted as requiring the board member to approach the affairs of the company in the same way that a 'prudent man' would approach their own affairs, Liability under the duty of care is frequently mitigated by the business judgment rule." The OECD defines "duty of loyalty" as "the duty of the board member to act in the interest of the company and shareholders. The duty of loyalty should prevent individual board members from acting in their own interest, or the interest of another individual or group, at the expense of the company and all shareholder."

³⁰ "Risk appetite" reflects the level or aggregate risk that the bank's Board is willing to assume and manage in the pursuit of the bank's business objectives. Risk appetite may include both quantitative and qualitative elements, as appropriate, and encompass a range of measures. For the purpose of this document, the terms "risk appetite" and "risk tolerance" are treated synonymously.

	<ul style="list-style-type: none"> ○ Alignment of the business model with the strategy, business goals and risk appetite. ○ The competitive advantages of the business model compared to other organizations ● Effectiveness of procedures for preventing conflicts of interest between the organization and members of the Board ● Effectiveness and adequacy of the organizations internal control and risk management system. <p>Within the risk-based supervision framework, the corporate governance team of FSD has, over the last two years, put a special emphasis on improving the quality of strategic planning processes and strategic plans in banks. This has resulted in developing enhanced supervisory expectations as to strategic plans and their process (please also see EC 1 above), greater challenge on banks' top management level by supervisors (via special annual meetings on this topics) and better integration of strategic plans in the on-going supervision process.</p>
EC6	The supervisor determines that the bank's Board, except where required otherwise by laws or regulations, has established fit and proper standards in selecting senior management, maintains plans for succession, and actively and critically oversees senior management's execution of Board strategies, including monitoring senior management's performance against standards established for them.
Description and findings re EC6	<p>Regulation 4 (paragraph 20) requires banks to develop internal regulations and policies on personnel management, including on principles of hiring and firing staff, career advancement, staff performance assessment, salary and bonus systems, etc.</p> <p>Appendix 43 of Regulation 1 "The Minimum Benchmark Requirements for Procedures of Selection, Appraisal of Fit and Proper and Professional Qualification of Branch Managers by the Banks and examination guidelines outlined in the RBS manual require examiners to make inquiries and judgments to assess the effectiveness of policies and processes for:</p> <ul style="list-style-type: none"> ● Ensuring that appropriate, correct and complete information is provided to the Board, enabling them to oversee the performance of senior management; ● Appointing or approving heads of the control functions; ● Ascertaining that control functions have adequate authority, independence and resources; ● Providing heads of control functions with unrestricted access to the board and its committees; ● Conducting regular, independent assessments of control functions. <p>During inspections, supervisors pay special attention to staff recruitment principles utilized by banks, job descriptions of key personnel and the extent to which there is a clear division of roles and responsibilities and clear lines of accountability. Supervisors also pay attention to the KPIs set for different levels of employees and managers to assess their adequacy and prudence.</p>
EC7	The supervisor determines that the bank's Board actively oversees the design and operation of the bank's and banking group's compensation system, and that it has appropriate incentives, which are aligned with prudent risk taking. The compensation system, and related performance standards, are consistent with long-term objectives and financial soundness of the bank and is rectified if there are deficiencies.
Description and findings re EC7	The requirements on compensation policies and systems are described in CBA Regulation 4 "Minimal Conditions of Internal Control in Banks." Although these requirements do not fully cover all the details of FSB standards, the requirements in the regulation are generally consistent with those standards. Policies required must address (1) incentives for risk taking that are consistent with the risk appetite and long-term goals of the bank, (2) fair treatment of customers by employees, (3) scope of coverage to include the bank's management and all

	<p>those employees whose activities can have a significant impact on the risk level of the bank, and (4) reporting and disclosure of potential conflicts of interest by staff.</p> <p>In the course of off-site supervision and during on-site inspections supervisors assess the compensation policies and systems in the scope of general governance and risk management framework. Identified problems with remuneration were not very severe, nor frequent, but in certain cases the examinations identified that the managers were paid bonuses even when the bank had losses, or the policies and procedures of paying out bonuses were not sufficiently transparent. Supervisors have required banks to clearly describe in internal regulatory documents the principles and criteria of paying bonuses and other types of compensation.</p>
EC8	The supervisor determines that the bank's Board and senior management know and understand the bank's and banking group's operational structure and its risks, including those arising from the use of structures that impede transparency (e.g., special-purpose or related structures). The supervisor determines that risks are effectively managed and mitigated, where appropriate.
Description and findings re EC8	<p>Through targeted reviews of material operations and their supporting governance structures, as well as targeted and thematic reviews on corporate governance, the supervisors assess the knowledge of the Board with regard to the bank's overall operations, inherent risks, and internal control structures. Supervisors also review reports to the Board from senior management with regard to their thoroughness and focus on potential risks. Supervisors also assess whether control function heads have unfettered access to the Board and are able to act without influence from business line managers. External audit is appointed by the General Meeting (shareholders) per suggestion of the Board (LBB, Article 21.1). The external auditor is required to report on any activities or risks not being reported through internal channels.</p> <p>For Armenian banks, the existence of complex financial structures that impede transparency has not been a significant issue.</p>
EC9	The supervisor has the power to require changes in the composition of the bank's Board if it believes that any individuals are not fulfilling their duties related to the satisfaction of these criteria.
Description and findings re EC9	The law gives the CBA the authority to de-register members of the Board if warranted.
Additional criteria	
AC1	Laws, regulations or the supervisor require banks to notify the supervisor as soon as they become aware of any material bona fide information that may negatively affect the fitness and propriety of a bank's Board member or a member of the senior management.
Description and findings re AC1	There is no such explicit requirement by laws, regulation or the supervisor. Article 58 of LBB defines, that if any deficiencies in internal control systems are identified during external audit, the external auditor is obliged to inform the CBA.
Assessment of Principle 14	Largely Compliant
Comments	A considerable amount of progress has been made in adapting regulations and procedures to widely accepted standards for corporate governance and outlining expectations for assessing management and control units in the RBS manual. The focus of CBA regulatory and supervisory initiatives has been on the role of the Board and its degree of oversight and understanding of significant risk-taking activities and related controls. The Corporate Governance risk team has also been effective in improving the quality and integration of bank strategic plans into the supervisory assessment and planning process and providing some initial baseline observations

	<p>regarding the role of bank chief risk officers. Examples cited from the field regarding corporate governance exceptions evidence a reasonably broad understanding of what is expected in this area.</p> <p>An overall rating of Largely Compliant is assigned to place continued emphasis on the implementation of supervisory guidance and building out a more structured (system-wide) understanding of corporate governance practices across all banks.</p>
Principle 15	Risk management process. The supervisor determines that banks³¹ have a comprehensive risk management process (including effective Board and senior management oversight) to identify, measure, evaluate, monitor, report and control or mitigate³² all material risks on a timely basis and to assess the adequacy of their capital and liquidity in relation to their risk profile and market and macroeconomic conditions. This extends to development and review of contingency arrangements (including robust and credible recovery plans where warranted) that take into account the specific circumstances of the bank. The risk management process is commensurate with the risk profile and systemic importance of the bank.³³
Essential criteria	
EC1	<p>The supervisor determines that banks have appropriate risk management strategies that have been approved by the banks' Boards and that the Boards set a suitable risk appetite to define the level of risk the banks are willing to assume or tolerate. The supervisor also determines that the Board ensures that:</p> <ul style="list-style-type: none"> (a) a sound risk management culture is established throughout the bank; (b) policies and processes are developed for risk-taking, that are consistent with the risk management strategy and the established risk appetite; (c) uncertainties attached to risk measurement are recognized; (d) appropriate limits are established that are consistent with the bank's risk appetite, risk profile and capital strength, and that are understood by, and regularly communicated to, relevant staff; and (e) senior management takes the steps necessary to monitor and control all material risks consistent with the approved strategies and risk appetite.
Description and findings re EC1	<p>The CBA formally adopted its risk-based supervision (RBS) program in January 2018, although the program has been in development for three years.</p> <p>Guidance for supervisors to determine that banks have approved risk management strategies and that Boards set a suitable risk appetite are included in the RBS manual which sets forth the overall supervisory approach. An important element of the approach is assessing the quality of risk management and governance to mitigate inherent risk in material operations (first tier assessment) and to derive a summary assessment for all business processes (second-tier</p>

³¹ For the purposes of assessing risk management by banks in the context of Principles 15 to 25, a bank's risk management framework should take an integrated "bank-wide" perspective of the bank's risk exposure, encompassing the bank's individual business lines and business units. Where a bank is member of a group of companies, the risk management framework should in addition cover the risk exposure across and within the "banking group" (see footnote 19 under Principle 1) and should also take account of risks posed to the bank or members of the banking group through other entities in the wider group.

³² To some extent the precise requirements may vary from risk type to risk type (Principles 15 to 28) as reflected by the underlying reference documents.

³³ It should be noted that while, in this and other Principles, the supervisor is required to determine that banks' risk management policies and processes are being adhered to, the responsibility of ensuring adherence remains with a bank's Board and senior management.

	<p>assessment). The risk management assessment specifically addresses a) the mandate of the risk management function to assess risks throughout the organization and the extent to which this mandate is communicated, (b) the appropriateness of an established risk appetite and capabilities for monitoring and reporting to the Board and senior management, (c) processes for assessing compliance with established limits and reporting to Board and (d) processes for identifying new potential risks or revisions to existing methods for measuring risk.</p> <p>These assessments are accomplished through targeted on-site inspections of material operations and supplemented by reviews of three-year business plans which are required to be submitted annually to the CBA. Targeted inspections include reviews of Board policies and minutes of Board and Committee meetings, reports provided to the Board, interviews with individual Board members, operations and control staff, communications to the staff, and documentation that supports actions taken by management to monitor and control material risks.</p> <p>In discussions with FSD staff and managers, it was apparent that more procedural guidance was needed with regard to evaluating inherent risks in material operations and risk mitigants. All risk teams are currently developing questionnaires and procedures to support better implementation of the risk-based approach.</p>
EC2	<p>The supervisor requires banks to have comprehensive risk management policies and processes to identify, measure, evaluate, monitor, report and control or mitigate all material risks. The supervisor determines that these processes are adequate:</p> <ul style="list-style-type: none"> (a) to provide a comprehensive “bank-wide” view of risk across all material risk types; (b) for the risk profile and systemic importance of the bank; and (c) to assess risks arising from the macroeconomic environment affecting the markets in which the bank operates and to incorporate such assessments into the bank’s risk management process.
Description and findings re EC2	<p>By Regulation 4, banks are required to have a risk management system that includes a risk management strategy, a risk appetite statement, risk management policies for individual risks, processes and tools for identification, assessment, mitigation, monitoring, and reporting of individual risks, descriptions of the duties and authorities of a bank’s individual business units and employees involved in the risk management process, and a quarterly ICAAP process consistent with the nature, volume, and complexity of the risks of the bank’s activities.</p> <p>The CBA conducts targeted examinations reviewing process documentation, output reports and communications to management and the Board to determine that all material risks are considered, that processes are appropriately comprehensive considering the risk profile of the bank, and that macroeconomic risks are incorporated in the bank’s risk management processes.</p> <p>See comments under EC 5 below.</p>
EC3	<p>The supervisor determines that risk management strategies, policies, processes and limits are:</p> <ul style="list-style-type: none"> (a) properly documented; (b) regularly reviewed and appropriately adjusted and reflected changing risk appetite, risk profiles and market and macroeconomic conditions; and (c) communicated within the bank. <p>The supervisor determines that exceptions to establish policies, processes and limits receive the prompt attention of, and authorization by, the appropriate level of management and the bank’s Board where necessary.</p>
Description and findings re EC3	<p>As discussed under EC 1 and EC2, the CBA conducts targeted inspections under its risk-based supervision program that focus on documentation, management responsiveness, and communications across the bank. Further, banks’ all internal regulations (policies) in general, and those related to risk management policies, strategies, processes and limits, in particular, are submitted to the CBA as well as any amendments made to them. The FSD has developed an</p>

	internal database of those regulations, which makes it easier for supervisors to search and find the required regulations of banks, compare new and old versions and review them.
EC4	The supervisor determines that the bank's Board and senior management obtain sufficient information on, and understand, the nature and level of risk being taken by the bank and how this risk relates to adequate levels of capital and liquidity. The supervisor also determines that the Board and senior management regularly review and understand the implications and limitations (including the risk measurement uncertainties) of the risk management information that they receive.
Description and findings of EC4	Point 137 of Regulation 4 requires the bank's internal policies to define the forms of reports submitted to the bank's Board and executive body, define procedures and frequency of submission, and the division/person responsible for submission. The reports should include the main business areas and should allow the Board and executive body to: (i) assess the current situation of the area, trend of changes, their impact on the bank's activity and level of riskiness, (ii) react timely and adequately and, if necessary, to undertake appropriate measures to solve the problems, identified in the area, (iii) assess the quality of work done by the division/person, responsible for the specific area, as well as the effectiveness of their activity, increase the effectiveness of decision-making process of the bank's Board and executive body by submitting the necessary information. According to point 66 of Regulation 4, banks should develop an appropriate reporting system, which will allow assessing how the changes of the bank's risk level impact its capital requirement. With a defined frequency, the bank's executive body and the Board should get a report from the staff responsible for risk management about the bank's risk level and adequate capital requirement. During onsite inspections the supervisors review the adequacy and completeness of information provided to the Board and senior management and assess whether the management of the bank understands the nature and risks of the bank and if the policies and procedures are effectively implemented in the bank.
EC5	The supervisor determines that banks have an appropriate internal process for assessing their overall capital and liquidity adequacy in relation to their risk appetite and risk profile. The supervisor reviews and evaluates banks' internal capital and liquidity adequacy assessments and strategies.
Description and findings re EC5	Point 61 of Regulation 4 specifies that the bank's executive body is responsible for developing the internal capital adequacy assessment process (ICAAP), defining a benchmark level of capital adequate to the bank's risk profile and risk management environment, as well as implementing a system for matching the bank's capital level with its risks. Point 63 of Regulation 4 defines that as a part of the bank's risk management system, the bank implements an internal capital adequacy assessment process at least on a quarterly basis, which should be consistent with the nature, volume and complexity of risks of the bank's activities. Point 95(20) of Regulation 4 specifies that the banks should regularly perform liquidity risk stress-tests (short-term and permanent, specific to the bank and broad market stress scenarios). Frequency of stress testing should be consistent with the structure of the bank's assets and exposure to liquidity risk. The results of stress tests should be used during liquidity planning (Regulation 4, point 79). Regulation 1 requires that banks send their internal policies to the CBA, so supervisors can assess banks' internal policies and the processes for banks internal capital adequacy assessments and liquidity planning. Assessors confirmed that ICAAP reports are submitted on an ad hoc basis; however, it did not appear consistent assessment criteria were used by the CBA and believe the quality of the bank submissions vary widely. Furthermore, although instances were noted where capital for a specific bank was set above the regulatory minimum, the ICAAP process is not linked to a regime for ensuring that capital levels stay above minimum levels, such as a prompt corrective action program.
EC6	Where banks use models to measure components of risk, the supervisor determines that: (a) banks comply with supervisory standards on their use;

	<p>(b) the banks' Boards and senior management understand the limitations and uncertainties relating to the output of the models and the risk inherent in their use; and</p> <p>(c) banks perform regular and independent validation and testing of the models.</p> <p>The supervisor assesses whether the model outputs appear reasonable as a reflection of the risks assumed.</p>
Description and findings re EC6	Banks are not allowed to use models for regulatory purposes, thus models are used solely for internal purposes. Banks are starting to use internal credit models in Armenia, for example credit application and behavioral scoring models. Point 57.1 of Regulation 4 specifies that when using internal models within the risk management process, the bank shall understand and take into consideration the potential shortcomings of the model. In addition, points 57.3 and 57.4 of Regulation 4 requires the banks to have an independent validation of internal models.
EC7	The supervisor determines that banks have information systems that are adequate (both under normal circumstances and in periods of stress) for measuring, assessing and reporting on the size, composition and quality of exposures on a bank-wide basis across all risk types, products and counterparties. The supervisor also determines that these reports reflect the bank's risk profile and capital and liquidity needs and are provided on a timely basis to the bank's Board and senior management in a form suitable for their use.
Description and findings re EC7	Regulation 4 defines that the banks should have valid and effective information and reporting systems. Intra-bank information flows and systems for circulation of documents should be used in all levels of bank's management for performing different operations/procedures and implementing monitoring over them. Banks should ensure the security and continuity of electronic systems of information storage and processing. The Regulation also requires banks to have policies and procedures that specify the format and frequency of reports provided to the Board and senior management. The CBA's supervisors assess during onsite examinations if these procedures are complied with.
EC8	The supervisor determines that banks have adequate policies and processes to ensure that the banks' Boards and senior management understand the risks inherent in new products, ³⁴ material modifications to existing products, and major management initiatives (such as changes in systems, processes, business model and major acquisitions). The supervisor determines that the Boards and senior management are able to monitor and manage these risks on an ongoing basis. The supervisor also determines that the bank's policies and processes require the undertaking of any major activities of this nature to be approved by their Board or a specific committee of the Board.
Description and findings re EC8	<p>Points 11 and 12 of Regulation 4 require that all the internal policies and procedures and internal control mechanisms, be reviewed in case of changes in the environment, as well as in cases of identification of new risks or any significant risk, significant deficiency or gap of the existing system. The changes in environment include new or modified information technologies as well as new services and types of activities, change of the organizational structure, change of the business-strategy of the bank, etc. As a result, the regulation stipulates that new products and major risk management initiatives are approved by the Board. Furthermore, point 57 of Regulation 4 requires that banks should assess the probable impact of new activities or services on the risk profile of the bank, and where necessary make changes in internal control and risk management systems of the bank. Also, point 76 of Regulation 4 requires banks to include the new products and services in the bank's stress testing framework.</p> <p>During on-site examinations the supervisor assesses whether the Board and senior management are able to monitor and manage the risks on an ongoing basis. Regulation 3 requires banks to submit a report on material changes and adverse developments (form 35) per every change and on a quarterly basis, which, inter alia, includes information on new or significantly changed products and services.</p>

³⁴ New products include those developed by the bank or by a third party and purchased or distributed by the bank.

EC9	The supervisor determines that banks have risk management functions covering all material risks with sufficient resources, independence, authority and access to the bank's Boards to perform their duties effectively. The supervisor determines that their duties are clearly segregated from risk-taking functions in the bank and that they report on risk exposures directly to the Board and senior management. The supervisor also determines that the risk management function is subject to regular review by the internal audit function.
Description and findings re EC9	<p>Chapters 13 and 14 of Regulation 4 define that banks must have an effective risk management function, which should support the banks processes for timely identification, measurement, control, monitoring and communication of its risks. The person/persons, responsible for implementation of risk management function, should identify the risks, inherent to the bank's activity, assess, monitor, help to effectively manage the identified risks, regularly assess the internal and external environment for early identification and assessment of potential risks, etc. Banks should ensure enough authority, independence and resources for the risk management function to effectively meet the responsibilities and reach the goals, defined for the function. The person responsible for implementation of the risk management function must have the opportunity to directly talk to and regularly meet with (without the presence of the executive body) with the Chairman of the Board. The potential for conflicts of interest within the risk management function should be minimized. At least on a quarterly basis, the person responsible for implementation of the risk management function submits reports to the Board and the executive body about circumstances, which can have a significant negative impact on the bank's risk management systems.</p> <p>Risk management functions in Armenian banks are segregated from risk taking functions, they are involved in developing risk appetite and limit systems, monitoring of main risk indicators, providing various risks analysis and developing various internal models, and proposing solutions to reduce risks. They report to the management and Board on a quarterly basis. Point 168 of Regulation 4 ranks the review of risk management function by internal audit as a high priority.</p>
EC10	The supervisor requires larger and more complex banks to have a dedicated risk management unit overseen by a Chief Risk Officer (CRO) or equivalent function. If the CRO of a bank is removed from his/her position for any reason, this should be done with the prior approval of the Board and generally should be disclosed publicly. The bank should also discuss the reasons for such removal with its supervisor.
Description and findings re EC10	<p>Regulations and CBA approval for senior management positions effectively require a bank to have a Chief Risk Officer or equivalent function.</p> <p>Article 21.13 of LBB and point 156 of Regulation 4 require all banks, irrespective of their size and complexity, to have an effective risk management function, which should support the bank in the timely identification, measurement, control, monitoring and communication of its risks. According to point 146 of Regulation 4, the Board's consent is required for appointment of the officers and staff responsible for implementation of the risk management function; early termination of their authorities; approving the conditions of compensation; regular assessment of their activities; and, disciplinary sanctions against them. The supervisors are in day-to-day contact with the bank and are aware of any removal of major employees (including the persons responsible for implementation of the risk management function).</p>
EC11	The supervisor issues standards related to, in particular, credit risk, market risk, liquidity risk, interest rate risk in the banking book and operational risk.
Description and findings re EC11	Prudential standards are enumerated in Regulation 2 with regards to capital charge for credit, market and operational risks, liquidity, FX and large exposures. Standards for risk management and internal controls for the risk enumerated in the criteria are established through Regulation 4, which was substantially revised in 2014 (and subsequently) to move towards a principles-based, risk-focused supervisory regime. The regulations are supplemented by an RBS

	<p>manual that was adopted formally in December 2017, and informal guidance on credit, liquidity and operational risk.</p> <p>Considering the developing nature of the financial system, new types of risk sources, as well as new principles and approaches suggested by the BCBS, the CBA is assessing the need to prepare additional guidance for banks. In this regard, the CBA has prepared questionnaires for banks to use in the conduct of a self-assessment on implementing risk management standards across all major risk areas. After analyzing the results of the self-assessment, the CBA will decide on next steps for greater clarification.</p>
EC12	<p>The supervisor requires banks to have appropriate contingency arrangements, as an integral part of their risk management process, to address risks that may materialize and actions to be taken in stress conditions (including those that will pose a serious risk to their viability). If warranted by its risk profile and systemic importance, the contingency arrangements include robust and credible recovery plans that take into account the specific circumstances of the bank. The supervisor, working with resolution authorities as appropriate, assesses the adequacy of banks' contingency arrangements in the light of their risk profile and systemic importance (including reviewing any recovery plans) and their likely feasibility during periods of stress. The supervisor seeks improvements if deficiencies are identified.</p>
Description and findings re EC12	<p>According to point 80 of Regulation 4, based on the results (impact on prudential ratios and/or assessed amount of loss) of performed stress tests, the bank develops its action plan for stress (emergency) situations. The emergency action plans describe changes the bank would contemplate in its major operations to address the potential stress losses. Plans reviewed by assessors included examples where stresses emanated from both retail and corporate portfolios. The bank's anticipated actions for retail portfolios included: hiring staff to address collections and problem loan management, monitoring high risk, large balance accounts more frequently, reviewing specific geographic or business sector concentrations for more scrutiny, revising underwriting standards. For corporate portfolios actions included: closer evaluation of collateral, strengthening underwriting and reducing risk appetites.</p> <p>These plans are not actively reviewed and discussed for crisis management purposes. They do not appear to meet expectations for recovery plans.</p>
EC13	<p>The supervisor requires banks to have forward-looking stress testing programs, commensurate with their risk profile and systemic importance, as an integral part of their risk management process. The supervisor regularly assesses a bank's stress testing program and determines that it captures material sources of risk and adopts plausible adverse scenarios. The supervisor also determines that the bank integrates the results into its decision making, risk management processes (including contingency arrangements) and the assessment of its capital and liquidity levels. Where appropriate, the scope of the supervisor's assessment includes the extent to which the stress testing program:</p> <ul style="list-style-type: none"> (a) promotes risk identification and control, on a bank-wide basis; (b) adopts suitably severe assumptions and seeks to address feedback effects and system-wide interaction between risks; (c) benefits from the active involvement of the Board and senior management; and (d) is appropriately documented and regularly maintained and updated. <p>The supervisor requires corrective action if material deficiencies are identified in a bank's stress testing program or if the results or stress tests are not adequately taken into consideration in the bank's decision-making process.</p>
Description and findings re EC13	<p>Chapter 6 of Regulation 4 requires banks perform stress testing at least for credit, FX, interest rate, price, liquidity and contagion risks. Stress testing for each risk should be performed based on the bank's assumptions, which must include market shocks reflecting at least two levels (moderate and severe) of extreme but probable conditions.</p>

	<p>Stress tests can be as simple as a sensitivity analysis, depending on the variations in a specific risk factor, or more complex taking into consideration different risk factors, including the results of systemic interconnection.</p> <p>Stress-testing is intended to be integrated with the bank's risk management process, and to promote the improvement of the quality of risk management and provide an additional tool of risk management. Scenarios, used for stress-testing, should be forward-looking, extreme but probable and allow assessing the bank's sensitivity to shock conditions.</p> <p>The Board of the bank should be responsible for ensuring necessary conditions for implementing an effective process of stress testing; and the executive body is responsible for consistent implementation of stress tests.</p> <p>The main assumptions under the stress tests, the main scenarios, the main judgments, used for assessment of stress tests results, as well as the methodology of measurement of probability of the events to occur, should be documented and circulated among the people responsible for the process.</p> <p>Article 78 of Regulation 4 defines that the bank's internal policies should describe the principles of performing stress tests, the procedures of developing the stress-scenario, those responsible for the process, the intended usage of the results of stress tests in the management decision making and risk management processes. Bank's policies should also define the procedures of making the results of stress tests available to the interested divisions and providing them to the Central Bank.</p> <p>The results of stress tests should have practical importance: they should affect the decision making of the bank's managers, including the strategic decisions of the bank's Board and executive body. Stress tests results should be used when defining the bank's risk appetite or the limits on separate risks, as well as during development of long-term business programs, capital and liquidity planning.</p> <p>Based on the results of performed stress tests, the bank should develop its action plan in stress situations.</p> <p>If material deficiencies are identified in the stress testing procedure or if the results of stress testing are not adequately taken into consideration in the bank's decision-making process, the supervisor may require the bank to address the issue.</p> <p>With regard to analyzing bank run stress tests, thus far the CBA has relied upon informal cooperation and sharing of practices among the institutional and risk teams. Given the increasing reliance on stress testing as a foundational part of the risk management assessment, the CBA should develop criteria for examiners to use in assessing the methodology used in the bank run tests, the integrity of data, and validity of models as well as assessing the results.</p>
EC14	<p>The supervisor assesses whether banks appropriately account for risks (including liquidity impacts) in their internal pricing, performance measurement and new product approval process for all significant business activities.</p>
Description and findings re EC14	<p>Regulation 4 specifies that the bank's internal control system concerning its lending activity, includes principles of pricing (formation of lending interest rates, factoring discount rates) in the bank. The regulation also specifies that the bank's internal control system concerning liquidity management, includes the mechanisms of pricing of the bank's assets (determining the interest rate) taking into consideration the bank's cost of funds, overhead expenses, credit risk and payable dividends.</p> <p>Further, the regulation also specifies that in the case of implementation of new operations or tools by the bank, the bank assesses their possible impact on the risk level of the bank's activity, if necessary, making changes in the risk management and internal control systems. In</p>

	<p>addition, the riskiness of such tools and operations should be subject to appropriate stress testing.</p> <p>The CBA conducted a thematic review in 2017 across seven banks regarding their practices in pricing consumer loan portfolios which addressed these topics.</p>
Additional criteria	
AC1	The supervisor requires banks to have appropriate policies and processes for assessing other material risks not directly addressed in the subsequent Principles, such as reputational and strategic risks.
Description and findings re AC1	<p>Regulations governing the ICAAP process require banks to have appropriate policies and procedures that define the criteria to consider risks as significant, ensure the identification, measurement of all significant risks by the bank and the flow of information about them. During the assessment of capital adequacy, all significant risks taken by the bank are being taken into consideration. The impact of external factors, such as business cycles and the macroeconomic environment, is also being assessed.</p> <p>Reputational and strategic risk are enumerated in regulation as needing to be addressed in a bank's internal risk assessment system. Of note however, is the RBS reference to reputational risk not being considered a distinct class of risk but included as a derivative of other financial and operational risks.</p>
Assessment of Principle 15	Largely Compliant
Comments	<p>The assessment of risk management in three firms reviewed by the assessors evidenced information gaps around control systems and the adequacy of internal reporting that need to be addressed via more detailed examination work. This is being addressed in supervisory plans for 2018 and 2019. However, in discussions with FSD staff and managers, it was also apparent that more procedural guidance was needed with regard to evaluating inherent risks in material operations and risk mitigants. All risk teams are currently developing questionnaires and procedures to support better implementation of the risk-based approach. It is recommended that the CBA proceed with the development of additional supervisory guidance on assessing risks (liquidity, market, operational, credit) and risk mitigation (corporate governance, risk management, internal controls).</p> <p>Although emergency action plans are required for all firms, they do not meet FSB expectations for recovery plans for large and significant banks. In particular, they do not anticipate sufficiently distressed conditions that would require changes to bank business models. Recommendations for recovery planning are addressed in a separate crisis management review.</p> <p>With regard to analyzing bank run stress tests, thus far the CBA has relied upon informal cooperation and sharing of practices among the institutional and risk teams. Given the increasing reliance on stress testing as a foundational part of the risk management assessment, the CBA should develop criteria for examiners to use in assessing the methodology used in the bank run tests, the integrity of data, and validity of models as well as assessing the results.</p> <p>Also, while ICAAP reports are submitted for review on an ad hoc basis, it did not appear a consistent assessment criteria were used by the CBA and assessors believe the quality of the bank submissions vary widely. Furthermore, although instances were noted where capital for a specific bank was set above the regulatory minimum, the ICAAP process is not linked to a regime for ensuring that capital levels stay above minimum levels, such as a prompt corrective action program.</p>

	As mentioned above, the CBA has implemented a principle-based regulation and risk-based supervision addressing different risks in the banking system. However, taking into account the developing financial system, new types of risk sources, as well as new principles and approaches suggested by the BCBS, the CBA is assessing the need to prepare additional guidance for banks. In this regard, the CBA has prepared questionnaires asking banks to conduct a self-assessment on their risk management implementation on main types of risks. After analyzing the results of the self-assessment, the CBA will decide on its future steps. It is recommended that the CBA move forward with its plans to have firms conduct these self-assessments and use the gaps identified in this process to enhance risk management guidance for banks.
Principle 16	Capital adequacy.³⁵ The supervisor sets prudent and appropriate capital adequacy requirements for banks that reflect the risks undertaken by, and presented by, a bank in the context of the markets and macroeconomic conditions in which it operates. The supervisor defines the components of capital, bearing in mind their ability to absorb losses. At least for internationally active banks, capital requirements are not less than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to calculate and consistently observe prescribed capital requirements, including thresholds by reference to which a bank might be subject to supervisory action. Laws, regulations or the supervisor define the qualifying components of capital, ensuring that emphasis is given to those elements of capital permanently available to absorb losses on a going concern basis.
Description and findings re EC1	<p>Article 44(1) of the LBB gives the CBA the authority to set capital adequacy ratios for banks. Point 28.1 of the "Banking, Prudential Standards for banking" Regulation 2 lays out the components of capital: the total capital of a bank is the sum of the core capital (Tier 1) and the additional capital (Tier 2) after respective deductions. The total capital/risk weighted assets ratio is set at 12% while the ratio of Tier 1/risk weighted assets, at 10%, will be effective in 2020 only. Additional capital shall be included in the total capital at an amount not exceeding currently 40% of the core capital and from January 1, 2020 at an amount not exceeding 20% of the core capital.</p> <p>The CBA implemented Basel II in 2008 requiring banks to adopt the standardized approach for credit risk, the standardized approach for market risk, and either the basic indicator or the standardized approach for operational risk.</p> <p>An amendment to the LBB, dated December 2017, creates a legal base for the CBA to fully implement Basel III requirements: the leverage ratio, capital buffers and (see CP 24) the LCR and NSFR.</p> <p>Since January 2015, requirements related to the items to be deducted/included in prudential capital calculation have been gradually introduced and became fully effective in January 2018. The only transitional floor relates to the inclusion of Tier 2 capital in the total capital in calculating core prudential standards. Additional capital (Tier 2) shall be included in the core capital at an amount not exceeding 40 % of the core capital (Tier 1) until December 31, 2018, at an amount not exceeding 30% of the core capital from January 1, 2019 to December 31, 2019 and at an amount not exceeding 20% of the core capital from January 1, 2020.</p>

³⁵ The Core Principles do not require a jurisdiction to comply with the capital adequacy regimes of Basel I, Basel II and/or Basel III. The Committee does not consider implementation of the Basel-based framework a prerequisite for compliance with the Core Principles, and compliance with one of the regimes is only required of those jurisdictions that have declared that they have voluntarily implemented it.

	<p>At end of May 2018, the average ratio for the whole sector is at 18,25%, with the bank with the lowest ratio at 13%. There is no specific Prompt Corrective Action Regulation that prescribes supervisory action in response to a bank breaching specified capital triggers, except in Regulation 2 Point 2.1 of the appendix 10 regarding Subordinated debt conversion, when banks CAR is less than 12.5%.</p> <p>A draft regulation on capital buffers is in the developmental stage and addresses the three buffers (conservation, countercyclical and systemic). Consultations with the industry are on-going. The most recent draft circulated at the end of June 2018 to the banking community gradually introduces a conservation buffer over a five-year period from 2020 (0.5%) to 2024 (2.5%) and a domestically systemically important banks buffer over 2 years from 1% in 2020 to 2% in 2021.</p>
EC2	At least for internationally active banks, ³⁶ the definition of capital, the risk coverage, the method of calculation and thresholds for the prescribed requirements are not lower than those established in the applicable Basel standards.
Description of findings re EC2	<p>While capital definitions and other aspects of calculation of capital requirements are aligned with Basel II and III, CBA has adopted higher minimum capital requirements than the Basel minimum with total capital/risk weighted assets ratio set at 12%. Historically, the CBA, taking into account the peculiarities and risks of the national economy, has adopted a policy of setting a tougher capital requirement to act as an additional loss-absorbing buffer. For assets denominated in FX, 50% stricter risk weights are applied, therefore the actual capital adequacy ratio for FX exposures reaches up to 18%.</p> <p>The ratio of Tier 1 capital/risk weighted assets at 10% will be effective in 2020. However, currently, the limitation of the additional capital (Tier 2) is limited at 40% of the core capital (Tier 1) until 2020 (see EC1).</p>
EC3	The supervisor has the power to impose a specific capital charge and/or limits on all material risk exposures, if warranted, including in respect of risks that the supervisor considers not have been adequately transferred or mitigated through transactions (e.g., securitization transactions) ³⁷ entered into by the bank. Both on-balance sheet and off-balance sheet risks are included in the calculation of prescribed capital requirements.
Description and findings re EC3	Article 44 (4) of LBB gives the CBA the authority to set tighter ratios for those banks where financial indicators have deteriorated or that engage in high-risk activities. The CBA has not yet used this power as capital adequacy ratios remain well above the minimum required in Armenian banks. In line with Regulation 2, off-balance sheet exposures are included in the capital calculations for credit and market risk.
EC4	The prescribed capital requirements reflect the risk profile and systemic importance of banks ³⁸ in the context of the markets and macroeconomic conditions in which they operate and

³⁶ The Basel Capital Accord was designed to apply to internationally active banks, which must calculate and apply capital adequacy ratios on a consolidated basis, including subsidiaries undertaking banking and financial business. Jurisdictions adopting the Basel II and Basel III capital adequacy frameworks would apply such ratios on a fully consolidated basis to all internationally active banks and their holding companies; in addition, supervisors must test the banks re adequately capitalized on a stand-alone basis.

³⁷ Reference documents: Enhancements to the Basel II framework, July 2009 and: International convergence of capital measurement and capital standards: a revised framework, comprehensive version, June 2006.

³⁸ In assessing the adequacy of a bank's capital levels in light of its risk profile, the supervisor critically focuses, among other things, on (a) the potential loss absorbency of the instruments included in the bank's capital base, (b) the appropriateness of risk weights as a proxy for the risk profile of its exposures, (c) the adequacy of provisions and reserves to cover loss expected on its exposures, and (d) the quality of its risk management and controls. Consequently, capital requirements may vary from bank to bank to ensure that each bank is operating with the appropriate level of capital to support the risks it is running and the risks it poses.

	constrain the build-up of leverage in banks and the banking sector. Laws and regulations in a particular jurisdiction may set higher overall capital adequacy standards than the applicable Basel requirements.
Description and findings re EC4	The minimum capital requirements are the same for all banks operating in Armenia. The CBA has tailored the Basel requirements to local specific circumstances, introducing higher risk weights for foreign exchange exposures. In addition, according to Article 44 of LBB, the CBA may set stricter prudential standards for an individual bank than for others, (which has been the case once) if the bank's comprehensive score is below the minimum threshold set by the CBA, financial indicators of the bank have deteriorated, the bank operates in high risk activities, or the bank is large and systemic. The CBA developed in 2014 an internal methodology based on the Basel guidelines on the identification of D-SIBs. The crisis management department shares the list of the D-SIBs every quarter with the FSD (three banks at end of March 2018).
EC5	The use of banks' internal assessments of risk as inputs to the calculation of regulatory capital is approved by the supervisor. If the supervisor approves such use: <ul style="list-style-type: none"> (a) such assessments adhere to rigorous qualifying standards; (b) any cessation of such use, or any material modification of the Bank's processes and models for producing such internal assessments, are subject to the approval of the supervisor; (c) the supervisor has the capacity to evaluate a bank's internal assessment process in order to determine that the relevant qualifying standards are met and that the bank's internal assessments can be relied upon as a reasonable reflection of the risks undertaken; (d) the supervisor has the power to impose conditions on its approvals if the supervisor considers it prudent to do so, and (e) if a bank does not continue to meet the qualifying standards or the conditions imposed by the supervisor on an ongoing basis, the supervisor has the power to revoke its approval.
Description and findings re EC5	The CBA does not allow banks to use their own internal assessments for the calculation of regulatory capital.
EC6	The supervisor has the power to require banks to adopt a forward-looking approach to capital management (including the conduct of appropriate stress testing). ³⁹ The supervisor has the power to require banks: <ul style="list-style-type: none"> (a) to set capital levels and manage available capital in anticipation of possible events or changes in market conditions that could have an adverse effect; and (b) to have in place feasible contingency arrangements to maintain or strengthen capital positions in times of stress, as appropriate in the light of the risk profile and systemic importance of the bank.
Description and findings re EC6	In accordance with Article 44 of LBB, the CBA sets prudential ratios for banks including capital adequacy ratios and can set new capital levels in anticipation of possible adverse events. In addition, point 61 of Regulation 4 defines that the bank's executive body is responsible for developing the internal capital adequacy assessment process (ICAAP), defining a benchmark level of capital adequate to the bank's risk profile and risk management environment. According to point 67, banks must use ICAAP results to detect whether the bank's existing capital is enough to withstand the bank's risks. If the existing amount of capital is not enough, the bank should decrease the level of its risk or increase the amount of its capital and reserves to meet both capital adequacy requirement and the additional requirement of capital under ICAAP results. Regulation 4, point 79, also states that the results of stress tests should be used during capital planning. Last, paragraph 68 of Regulation 4 requires banks to assess their capital adequacy taking into account forward looking elements such as the growth rate of the bank, the bank's current and future expenses and trends and variability of volume changes.

³⁹ "Stress testing" comprises a range of activities from simple sensitivity analysis to more complex scenario analyses and reverses stress testing.

Additional criteria	
AC1	For non-internationally active banks, capital requirements, including the definition of capital, the risk coverage, the method of calculation, the scope of application and the capital required, are broadly consistent with the principles of the risk profile and systemic importance of the banks.
Description and findings re AC1	The definition of capital, the method of calculation and the capital required are in line with the principles of the applicable Basel requirements for all banks.
AC2	The supervisor requires adequate distribution of capital within different entities of a banking group according to the allocation of risks. ⁴⁰
Description and findings re AC2	For groups classified in non-low-risk category, capital adequacy is calculated on a consolidated and solo basis. All financial companies are consolidated in the reporting. Hence, capital distribution takes place with different entities of a banking group according to allocation of risks. For groups classified in low risk category, prudential standards do not apply on consolidated basis. However, if considered risky or potentially risky, these groups can be reclassified.
Assessment of Principle 16	Largely Compliant
Comments	<p>The current capital adequacy requirement applied to all banks in Armenia is mostly based on the components of the standardized approach of Basel II. The CBA is implementing a Basel III plan, which should lead to Basel III full compliance in the next 5 years. As a practical matter, almost all capital of Armenian banks is CET1 as there is only a small market for subordinated or hybrid instruments. Armenian banks are already required to maintain a total capital ratio of 12 percent and in most cases report significantly higher capital, so there should be no practical difficulty meeting Basel III capital requirements.</p> <p>The CBA is in the process of adopting other elements of Basel III (capital buffers and potentially a leverage ratio). Capital is calculated on a consolidated and solo basis for all banks and CBA has the authority to impose additional capital requirements on individual banks, as deemed necessary, but it has not yet set minimum capital ratios for banks based on their risk profile, except in one case. Also, the CBA has not introduced a leverage ratio as previous simulation had shown a sector level of 13% in 2011, and 12.4% in 2017(calculated based on Basel methodology), but it has started discussing the introduction of such a ratio because recent analysis has shown greater divergence between banks. However, the lowest level of the leverage ratio in the banking system (5.3%) is quite above the Basel minimum level (3%), not making the introduction of the ratio as high priority. No draft regulation has been prepared yet. Banks are required to use their own ICAAP results to detect whether their existing capital is enough to withstand the bank's risks, but CBA does not receive nor challenge the outcome of these exercises, except on an ad hoc basis. More generally, it has not comprehensively implemented BII Pillar 2 approach though implementation of the risk-based approach is contemplated as a first step.</p>
Principle 17	Credit risk.⁴¹ The supervisor determines that banks have an adequate credit risk management process that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify,

⁴⁰ Please refer to Principle 12, Essential Criterion 7.

⁴¹ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

	measure, evaluate, monitor, report and control or mitigate credit risk⁴² (including counterparty credit risk)⁴³ on a timely basis. The full credit lifecycle is covered including credit underwriting, credit evaluation, and the ongoing management of the bank's loan and investment portfolios.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate credit risk management processes that provide a comprehensive bank-wide view of credit risk exposures. The supervisor determines that the processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank, take into account market and macroeconomic conditions and result in prudent standards of credit underwriting, evaluation, administration and monitoring.
Description and findings re EC1	<p>Regulation 4 sets forth requirements for risk management systems in banks as described in more detail under CP 15, EC 2. Specifically, with regard to credit risk management, banks are required to have a methodology which allows for assessing credit risk both for a single borrower and the portfolio as a whole. Banks are required to implement credit risk analysis for individual portfolios, identifying portfolio problems, including risk concentrations and large exposures. Banks must review used/unused amounts of credit lines on a daily basis and assess total and net risks, taking into account collateral and guarantees.</p> <p>The CBA conducts targeted examinations reviewing process documentation, output reports and communications to management and the Board to determine that all material risks are considered, that processes are appropriately comprehensive considering the risk profile of the bank, the systemic importance of the bank as a lender, and the overall financial strength of the bank. Examinations also determine to what extent macroeconomic risks are incorporated and result in prudent standards of underwriting, evaluating, administering and monitoring credit risk.</p>
EC2	The supervisor determines that a bank's Board approves, and regularly reviews, the credit risk management strategy and significant policies and processes for assuming, ⁴⁴ identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk (including counterparty credit risk and associated potential future exposure) and that these are consistent with the risk appetite set by the Board. The supervisor also determines that senior management implements the credit risk strategy approved by the Board and develops the aforementioned policies and processes.
Description and findings re EC2	<p>The regulations require that bank Board's approve and regularly review the credit risk management strategy and significant policies and processes for assuming, identifying, measuring, evaluating, monitoring, reporting and controlling or mitigating credit risk; and, that they are consistent with the risk appetite set by the Board.</p> <p>During targeted on-site credit reviews and off-site via the database for internal policies, supervisors routinely review internal policies and procedures to determine to what extent banks are compliant with these regulations. Supervisors assess actual implementation of these policies via interviews with bank managers and other staff, participate in or review minutes of various committee discussions on credit issues, and review information and documentation generated through internal management systems.</p>

⁴² Credit risk may result from the following: on-balance sheet and off-balance sheet exposures, including loans and advances, investments, inter-bank lending, derivatives transactions, securities financing transactions and trading activities.

⁴³ Counterparty credit risk includes credit risk exposures arising from OTC derivative and other financial instruments.

⁴⁴ "Assuming" includes the assumption of all types of risk that give rise to credit risk, including credit risk or counterparty risk associated with various financial instruments.

	In addition, credit files are sampled, and financial analysis is conducted by supervisors to confirm borrowers' creditworthiness. The CBA has developed a sampling methodology that calculates the minimum number of loans that would be considered statistically representative, and includes factors such as size of loans, nonperforming status, and economic sector. To confirm creditworthiness, supervisors review and challenge borrower's financial information by analyzing profitability, liquidity and capital, financial forecasts, cash flow, and the quality of collateral.
EC3	<p>The supervisor requires, and regularly determines, that such policies and processes establish an appropriate and properly controlled credit risk environment, including:</p> <ul style="list-style-type: none"> (a) a well-documented and effectively implemented strategy and sound policies and processes for assuming credit risk, without undue reliance on external credit assessments; (b) well defined criteria and policies and processes for approving new exposures (including prudent underwriting standards) as well as for renewing and refinancing existing exposures, and identifying the appropriate approval authority for the size and complexity of the exposures; (c) effective credit administration policies and processes, including continued analysis of a borrower's ability and willingness to repay under the terms of the debt (including review of the performance of underlying assets in the case of securitization exposures); monitoring of documentation, legal covenants, contractual requirements, collateral and other forms of credit risk mitigation; and an appropriate asset grading or classification system; (d) effective information system for accurate and timely identification, aggregation and reporting of credit risk exposures to the bank's Board and senior management on an ongoing basis; (e) prudent and appropriate credit limits, consistent with the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff; (f) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board where necessary; and (g) effective controls (including in respect of the quality, reliability and relevancy of data and in respect of validation procedures) around the use of models to identify and measure credit risk and set limits.
Description and findings re EC3	Regulation 4 defines the minimum requirements that must be in place. Paragraph 85 of this Regulation requires a well-documented strategy, sound policies and processes, procedures for granting loans, members of the credit committee as well as their authority and decision-making procedures. The same paragraph also specifies the requirement for the procedures for monitoring and recovering loans, acceptable types of collateral, LTV ratios and procedures for the classification of loans, cases or basis of possible exceptions from the approved policies and/or limits, etc. Paragraph 86 establishes requirements on collateral valuation and control processes, while Paragraph 89 sets minimum loan documentation requirements. Paragraph 92 of Regulation 4 states that the reports submitted to the Board must include at least the credit portfolio structure, credit portfolio quality, main directions of credits, loan concentrations, large loans and loans provided to related parties. According to paragraph 88 of Regulation 4 all lending exceptions should be appropriately justified and kept in loan documentation. Any such exceptions to the Board's established risk appetite and limits should be presented and discussed at the Board (paragraph 56). The procedures for the identification of problem assets, as well as renewing and refinancing thereof in banks must be in line with the Regulation "Procedure on classification of loans and receivables and creation of possible loss reserves for banks" set by the CBA. Paragraph 85 of Regulation 4 also requires policies and procedures to include limits on credit concentrations, principles of loan diversification and lending limits by loan value, term, and country.

	Banks' policies and procedures are submitted to the CBA and reviewed for completeness on a regular basis. Compliance with the policies and procedures is verified during the onsite examination as discussed under EC 2.
EC4	The supervisor determines that banks have policies and processes to monitor the total indebtedness of entities to which they extend credit and any risk factors that may result in default including significant unhedged foreign exchange risk.
Description and findings re EC4	<p>The total indebtedness of borrowers is available from the credit bureau which banks consult before they extend credit. The CBA credit manual requires banks to take into account the amount of existing indebtedness of the borrower and earnings capacity to service total debt when making new extensions of credit. The ACRA credit bureau started collecting information from January 2007.</p> <p>With regard to unhedged foreign exchange risk, the 2012 BCP assessment highlighted the need to (i) more clearly define and distinguish between FX risk arising from a mismatch at the level of the borrower and FX risk arising from banking activity, and (ii) issue good risk management practices in the area of indirect foreign exchange, beyond higher capital and provisions, e.g., stricter LTV ratios and lower concentrations of large borrowers.</p> <p>In March 2012 the CBA issue a letter to banks regarding the importance of good risk management and referencing expectations outlined in the BCBS guidance on Credit Risk Management Principles. The letter also initiated a series of ad hoc information collections in 2014, 2015 and 2017 asking banks to provide information either from their systems or via manual tabulation on the 10 largest unhedged FX borrowers. In addition, for the 2017 report, the CBA inquired about all unhedged borrowings in the SME and mortgage portfolios. While those reports showed high levels of unhedged exposures, there was little change in the percentages of unhedged borrowers or among the types of unhedged loans from year to year.</p> <p>Effective June 1, 2018, the CBA amended Regulation 4 to establish a consistent definition of unhedged FX credit risk and require banks to identify and monitor such risk. Regarding the specific risk management suggestions for stricter LTVs or lower concentration limits, the CBA amended LBB in 2017 establishing their authority to introduce LTV or DTI ratios, but no regulations have been enacted. However, CBA has a general rule assigning 50% higher risk weights for unhedged FX exposures.</p>
EC5	The supervisor requires that banks make credit decisions free of conflicts of interest and on an arm's length basis.
Description and findings re EC5	Article 38 of the LBB defines that banks must set internal rules for their operations to exclude conflicts of interest. During onsite examinations, the CBA supervisors assess the adherence to those internal rules. The LBB also specifies rules for conflicts of interest at the Board level.
EC6	The supervisor requires that the credit policy prescribes that major credit risk exposures exceeding a certain amount or percentage of the bank's capital are to be decided by the bank's Board or senior management. The same applies to credit risk exposures that are especially risky or otherwise not in line with the mainstream of the bank's activities.
Description and findings re EC6	<p>Regulation 4 specifies that the control mechanisms, adopted by the bank, must address cases where limits are exceeded by describing the decision-making process and who is authorized to grant such exceptions. The regulation also specifies that any transaction that results in a deviation from the risk management strategy, risk appetite and/or risk limits approved by the bank's Board, should be discussed in detail and presented for the Board's approval. Also, information about large loans is regularly reported to the CBA as part of the monthly reporting requirement.</p> <p>During onsite examinations, supervisors check if the decision of granting a loan that exceeds particular limits has been made by an authorized person/body.</p>

EC7	The supervisor has full access to information in the credit and investment portfolios and to the bank officers involved in assuming, managing, controlling and reporting on credit risk.
Description and findings re EC7	In accordance with Article 39.4 of the LCB, the supervisor has full access to information about the banks credit or investment portfolios, even if it contains any banking, commercial or other secrets. During on-site examinations and off-site supervision, supervisors meet with the banks' management. Article 57 (3) also states that the bank and branches must support the staff of the CBA during their supervision.
EC8	The supervisor requires banks to include their credit risk exposures into their stress testing programs for risk management purposes.
Description and findings re EC8	Chapter 6 of Regulation 4 specifies that banks should perform stress-testing for credit risk on a quarterly basis. Stress testing should form a part of the bank's risk management process, promote the improvement of the quality of risk management and provide an additional tool of risk management. The results of stress tests should affect the decision making of the bank's managers: in particular, they should be used when defining the bank's risk appetite or the limits on credit risk.
Assessment of Principle 17	Largely Compliant
Comments	Loans denominated in foreign currency represent 64 percent of Armenian bank loan portfolios. The CBA estimates that unhedged borrowers represent about 70% of FX lending. In order to offset the risk in the FX portfolio the CBA has instituted higher risk weights on FX lending (150%) and higher provisioning requirements (120% of non-FX loans). In addition, the CBA recently implemented a requirement under Regulation 4 that banks identify and track hedged/unhedged borrowers according to a newly established supervisory definition. While assessors would reiterate the need for strong risk management expectations as identified in 2012, at a minimum, supervisors should monitor the implementation of tracking and risk management systems that will be required under the recently enacted amendments to Regulation 4. In addition, the CBA should consider implementing formal reporting to better monitor and analyze unhedged FX risk.
Principle 18	Problem assets, provisions and reserves.⁴⁵ The supervisor determines that banks have adequate policies and processes for the early identification and management of problem assets, and the maintenance of adequate provisions and reserves.⁴⁶
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to formulate policies and processes for identifying and managing problem assets. In addition, laws, regulations or the supervisor require regular review by banks of their problem assets (at an individual level or at a portfolio level for assets with homogenous characteristics) and asset classification, provisioning write-offs.
Description and findings re EC1	Article 57 paragraph 5 of the LBB requires the CBA in cooperation with Ministry of Finance (MOF) to adopt regulations for loan loss provisioning. In line with this article, the CBA and MOF have issued the "Procedure on the classification of loans and receivables and the creation of possible loss reserves for banks". It requires banks to establish internal policies aligned with the regulation and submit them to the CBA for review. The regulation on asset classification also requires banks to review, classify and provision for credit risk, be it on or off-balance sheet on a monthly basis and report the results to the CBA. Classifications are done based on objective criteria (days past due, restructuring, interest capitalization), and subjective criteria (judgment

⁴⁵ Principle 17 covers the evaluation of assets in greater detail; Principle 18 covers the management of problem assets.

⁴⁶ Reserves for the purposes of this Principle are "below the line" non-distributable appropriations of profit required by a supervisor in addition to provisions ("above the line" charges to profit).

	and professional opinion of banks and the Financial Supervision Department of the CBA in line with definitions and guidance provided for in the Regulation), and the most conservative analysis has to be used.																		
EC2	The supervisor determines the adequacy of a bank's policies and processes for grading and classifying its assets and establishing appropriate and robust provisioning levels. The reviews supporting the supervisor's opinion may be conducted by external experts, with the supervisor reviewing the work of the external experts to determine the adequacy of the bank's policies and processes.																		
Description and findings re EC2	<p>The CBA reviews the internal policies for each bank to assess if they are in line with the regulation. During onsite inspections, CBA supervisors assess the implementation of the policies and processes for asset classification as well as the adequacy of the loan loss provisions. Off-site analysis of these internal policies is also performed via the credit registry.</p> <p>For retail portfolios, supervisors usually review the adequacy of provisioning on a portfolio level via such analytical tools as migration analysis, vintage analysis, etc. Supervisors have in past imposed additional provisions on various banks for their risky portfolios of consumer loans. The credit risk team of FSD is currently in the process of implementing targeted on-site reviews of consumer loan risk management in seven banks, where the quality of portfolio is also being reviewed. For corporate loans, supervisors perform sampling and review loan documentation and financial position of borrowers and based on that determine the adequacy of classification and provisioning of those loans.</p>																		
EC3	The supervisor determines that the bank's system for classification and provisioning takes into account off-balance sheet exposures. ⁴⁷																		
Description and findings re EC3	In accordance with point 2.1 of the "Procedure on the classification of loans and receivables and the creation of possible loss reserves for banks," off-balance sheet exposures are taken into account for the provisioning requirements.																		
EC4	The supervisor determines that banks have appropriate policies and processes to ensure that provisions and write-offs are timely and reflect realistic repayment and recovery expectations, taking into account market and macroeconomic conditions.																		
Description and findings re EC4	<p>According to the CBA regulation, banks must have internal policies on asset classification and provisioning. These legal acts must meet the requirements of CBA regulation. The minimum and maximum percentages for regulatory provisioning in the Regulation are as follows:</p> <table border="1"> <thead> <tr> <th>Assets classes</th> <th>Min and max provisioning percentages for exposure in local currency</th> <th>Min and max provisioning for exposures in foreign currency</th> </tr> </thead> <tbody> <tr> <td>Standard asset</td> <td>1% - 2% general provision</td> <td>1% - 2% general provision</td> </tr> <tr> <td>Watch</td> <td>10% - 15%</td> <td>12% - 18 %</td> </tr> <tr> <td>Sub-standard asset</td> <td>20% - 25%</td> <td>24% - 30%</td> </tr> <tr> <td>Doubtful asset</td> <td>50% - 70%</td> <td>60% - 85%</td> </tr> <tr> <td>Loss</td> <td>100%</td> <td>100%</td> </tr> </tbody> </table>	Assets classes	Min and max provisioning percentages for exposure in local currency	Min and max provisioning for exposures in foreign currency	Standard asset	1% - 2% general provision	1% - 2% general provision	Watch	10% - 15%	12% - 18 %	Sub-standard asset	20% - 25%	24% - 30%	Doubtful asset	50% - 70%	60% - 85%	Loss	100%	100%
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EC5	The supervisor determines that banks have appropriate policies and processes, and organizational resources for the early identification of deteriorating assets, for ongoing oversight of problem assets, and for collecting on past due obligations. For portfolios of credit exposures with homogeneous characteristics, the exposures are classified when payments are contractually in arrears for a minimum number of days (e.g., 30, 60, 90 days). The supervisor tests banks' treatment of assets with a view to identifying any material circumvention of the																		

⁴⁷ It is recognized that there are two different types of off-balance sheet exposures: those that can be unilaterally cancelled by the bank (based on contractual arrangements and therefore may not be subject to provisioning), and those that cannot be unilaterally cancelled.

	classification and provisioning standards (e.g., rescheduling, refinancing or reclassification of loans).
Description and findings re EC5	<p>Point 85(6) of Regulation 4 defines that the bank's internal control system, concerning its lending activity, should at least include the principles of granting, monitoring and recovering loans. Point 83(12) of the same Regulation specifies that the bank's internal control system, concerning its investment activity, should at least include the principles and procedures of investment classification and provisioning against non-performing assets; scope and duties of people responsible for its measurement and regular monitoring, as well as the procedures of recovering the bank's overdue assets. During onsite examinations, the supervisors examine the implementation of banks' internal policies and processes and organizational resources for early identification of deteriorating assets, for ongoing oversight of problem assets and for collection of past due obligations.</p> <p>In accordance with the Regulation "Procedure on the classification of loans and receivables and the creation of possible loss reserves for banks" loans are required to be classified when payments are contractually a minimum number of days in arrears (1, 90, 180, 270 days). Restructuring (refinancing) of non-performing loans does not lead to improved classification of such loans, moreover restructuring (refinancing) of standard and watch loans will lead to reclassifying such loans as sub-standard (at least).</p>
EC6	The supervisor obtains information on a regular basis, and in relevant detail, or has full access to information concerning the classification of assets and provisioning. The supervisor requires banks to have adequate documentation to support their classification and provisioning levels.
Description and findings re EC6	An off-site process to assess the compliance with the Regulation "Procedure on the classification of loans and receivables and the creation of possible loss reserves for banks" and the bank's internal policies is in place. Form 6 of Regulation 3 provides comprehensive and detailed information on banks' asset classifications and provisions, including both stock and flow data for on and off-balance sheet exposures. In addition, the Credit Registry operates within the Central bank which also contains the information on the classification of assets. The CBA examiners regularly call for copies of credit files or transaction information to support their off-site analysis. The CBA also performs targeted examinations in this area in case of doubt or uncertainty regarding specific trends. In addition, point 90(10) of Regulation 4 specifies that the documents, available in the loan book, should at least include the information on classification of the loan, as well as the reasons of classification. According to point 92 of Regulation 4, the reports submitted to the Bank's Board and executive body, should at least include problematic (overdue) loans with information supporting the classification of such loans.
EC7	The supervisor assesses whether the classification of the assets and the provisioning is adequate for prudential purposes. If asset classifications are inaccurate or provisions are deemed to be inadequate for prudential purposes (e.g., if the supervisor considers existing or anticipated deterioration in asset quality to be of concern or if the provisions do not fully reflect losses expected to be incurred), the supervisor has the power to require the bank to adjust its classifications of individual assets, increase its levels of provisioning, reserves or capital and, if necessary, impose other remedial measures.
Description and findings re EC7	<p>Point 1.5 of the "Procedure on the classification of loans and receivables and the creation of possible loss reserves for banks" gives the CBA the power to require the bank to adjust and increase its level of provisions and reserves if the CBA has concerns. CBA has many examples when supervisors have forced a bank or banks to adjust or increase their provisions. The CBA does frequent off site analysis of the asset classification returns.</p> <p>Furthermore, according to the paragraph 4.6 of the "Procedure on the classification of loans and receivables and the creation of possible loss reserves for banks", the CBA Supervision Department is entitled to require banks to make additional provisions for either specific assets or group of assets without classifying those asset(s). The CBA has adopted a special regulation on such additional provisioning (Decision 143A dated 29/05/2012) covering topics such as</p>

	grounds for imposing additional provisions, level of such provisions, process of making and reversing them in future (when grounds no longer exist). There have been several instances where the CBA has practiced this power and imposed additional provisions on different banks for their riskier portfolios.									
EC8	The supervisor requires banks to have appropriate mechanisms in place for regularly assessing the value of risk mitigants, including guarantees, credit derivatives and collateral. The valuation of collateral reflects the net realizable value, taking into account prevailing market conditions.									
Description and findings re EC8	Risk mitigants (including guarantees, credit derivatives and collateral) are not taken into account neither for asset classification, nor for the calculations of provisions. Nevertheless, during the onsite examinations CBA supervisors verify the processes and procedures for collateral evaluation. Specific requirements are included in the Regulation "Minimum requirements for bank's internal control". In particular, point 86(3) of Regulation 4 specifies that the internal control system of assessment and control of the collateral should at least include the procedure and frequency of implementing collateral revaluation. Point 91(3) of Regulation 4 defines that the loan monitoring process should at least include, inter alia, regular revaluation of collateral.									
EC9	Laws, regulations or the supervisor establish criteria for assets to be: <ul style="list-style-type: none"> (a) identified as a problem asset (e.g., a loan is identified as a problem asset when there is reason to believe that all amounts due, including principal and interest will not be collected in accordance with the contractual terms of the loan agreement); and (b) reclassified as performing (e.g., a loan is reclassified as performing when all arrears have been cleared and the loan has been brought fully current, repayments have been made in a timely manner over a continuous repayment period and continued collection, in accordance with the contractual terms, is expected). 									
Description and findings re E9	<p>The Regulation "Procedure on the classification of loans and receivables and the creation of possible loss reserves for banks" (point 2.6) provides the definition of non-performing assets. Non-performing assets are the assets for which:</p> <ul style="list-style-type: none"> a) the repayment of principal (or part thereof) or the payment of interest has fallen overdue from the date specified in the contract; or b) the payment of interest has been capitalized (added to the outstanding loan amount); or c) the terms have been revised (refinanced) or assigned to the new loan amount. <table border="1" data-bbox="386 1312 1442 1871"> <thead> <tr> <th>Asset class</th> <th>Objective criteria</th> <th>Subjective criteria [criteria are summarized from para 3.7-3.10]</th> </tr> </thead> <tbody> <tr> <td>Standard asset</td> <td>A performing asset which is being repaid in accordance with the contract</td> <td>The financial condition of the borrower is not doubtful, and the borrower has sufficient ability to repay the debt. These assets are well secured in respect of interest and principal.</td> </tr> <tr> <td>Watch</td> <td>Is non-performing up to 90 days</td> <td>Assets are still served by the initial agreement, but the financial condition of the borrower worsened or appears to worsen. As a result of this, the ability of the borrower to repay the debt could be endangered.</td> </tr> </tbody> </table>	Asset class	Objective criteria	Subjective criteria [criteria are summarized from para 3.7-3.10]	Standard asset	A performing asset which is being repaid in accordance with the contract	The financial condition of the borrower is not doubtful, and the borrower has sufficient ability to repay the debt. These assets are well secured in respect of interest and principal.	Watch	Is non-performing up to 90 days	Assets are still served by the initial agreement, but the financial condition of the borrower worsened or appears to worsen. As a result of this, the ability of the borrower to repay the debt could be endangered.
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Asset class	Objective criteria	Subjective criteria [criteria are summarized from para 3.7-3.10]
Sub-standard asset	Is non-performing from 91 to 180 days	<p>The borrower fails to discharge its obligations under the contract due to its financial condition. These include</p> <ul style="list-style-type: none"> - term assets which cannot be timely settled due to insufficient cash flow of the borrower. - loans, advances, and other liabilities of the borrower that have insufficient ratio of equity capital to attracted funds as defined in banks' internal regulations. - restructured assets. - assets which have higher risk due to incomplete information on borrowers' financial situation or collateral, or due to use of the loan proceeds for other objectives (than prescribed in the contract). - assets with insufficient collateral and assets which have been restructured multiple times with little repayment of loan.
Doubtful asset	Is non-performing from 181 to 270 days past due status	Same characteristics as substandard assets but collectability is more difficult or even impossible. The likelihood of losses increases but there is still a possibility the asset status will improve.
Loss	With a 271 days and more past due status	Non-collectible and completely impaired assets.

The Regulation classifies assets into 5 categories: standard, watch, substandard, doubtful, loss. It lists subjective and objective impairment triggers and the strictest trigger should be taken into account.

For assets without specific repayment terms (overdrafts, revolving credits), the objective criterion in the regulation requires that 25% of the outstanding balance has to be repaid on a quarterly basis.

Also, paragraph 2.7 of the "Procedure on the classification of loans and receivables and the creation of possible loss reserves for banks" identifies those assets that are "unsecured (non-collateralized)" and hence, are considered impaired and should be written off. These include, assets that:

- (1) are not secured by collateral, a warranty, guarantee or budget guarantee of any legal entity, which has been operating with profit for at least the previous and current reporting periods, and
- (2) are not provided with sufficient information on the financial condition, (including financial flows), of the borrower,
- (3) lack of information backing the collectability of the borrower's debt (business plans, contracts, etc.), as well as essential documents,

	<p>(4) are not advance payments or prepayments against the purchase of products, activities, or services.</p> <p>See Comments for a discussion of NPL and restructured loans.</p>
EC10	The supervisor determines that the bank's Board obtains timely and appropriate information on the condition of the bank's asset portfolio, including classification of assets, the level of provisions and reserves and major problem assets. The information includes, at a minimum, summary results of the latest asset review process, comparative trends in the overall quality of problem assets, and measurements of existing or anticipated deterioration in asset quality and losses expected to be incurred.
Description and findings re EC10	Paragraph 92 of Regulation 4 defines that the reports, submitted to the bank's Board regularly, should at least include the structure and quality of the loan portfolio, main directions of the loans, credit concentrations, large exposures, loans to related parties, as well as information on problematic (overdue) loans, information supporting the classification of such loans, as well as the measures undertaken to recover (repay) the overdue loans. During onsite examinations, the CBA supervisors also ensure that the Board receives timely and appropriate information on the condition of the bank's asset portfolio. As necessary, the supervisors require the reports or the Board meeting excerpts to be submitted for off-site review.
EC11	The supervisor requires that valuation, classification and provisioning, at least for significant exposures, are conducted on an individual item basis. For this purpose, supervisors require banks to set an appropriate threshold for the purpose of identifying significant exposures and to regularly review the level of the threshold.
Description and findings re EC11	The general approach of the "Procedure on the classification of loans and receivables and the creation of possible loss reserves for banks" is that all assets, irrespective of their size and significance, are being classified and provisioned on an individual item basis.
EC12	The supervisor regularly assesses any trends and concentrations in risk and risk build-up across the banking sector in relation to banks' problem assets and takes into account any observed concentration in the risk mitigation strategies adopted by banks and the potential effect on the efficacy of the mitigant in reducing loss. The supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of this assessment.
Description and findings re EC12	<p>The supervisor regularly receives and assesses information about the asset' quality of the banks' credit portfolios.</p> <p>The credit risk team of FSD is responsible for supervisory credit risk across the banking system. One such recent example of their work is the assessment of corporate restructuring practices in banks to assess the level, quality and effectiveness of those restructurings.</p> <p>The Financial System Stability and Development Department also regularly assesses the trends and concentrations in relation to banks' problem assets.</p> <p>During their day-to-day work, the supervisor considers the adequacy of provisions and reserves at the bank and banking system level in the light of these assessments. The CBA discussed instances in which higher reserves and/or provisions were required based on risks to an entire portfolio, (e.g., credit card lending).</p>
Assessment of Principle 18	Largely Compliant
Comments	Currently, the CBA uses a non-standard definition of non-performing loans (day 1 of delinquency) and has a definition of restructured loans that is not well supported by examples or detailed supervisory explanations. Also, the CBA does not provide detailed guidance on evaluating performance periods for restoring restructured loans to performing status, and instead assesses the adequacy of banks' internal regulations, where these periods are established, on a case-by-case basis.

	<p>The CBA should strongly consider aligning its definitions for non-performing and forborne (restructured) loans with the BCBS guidance issued in April 2017 regarding “Prudential treatment of problem assets—definitions of non-performing exposures and forbearance.” As stated in the guidance, it is intended to complement the existing accounting and regulatory framework in relation to asset categorization. It will harmonize the scope, recognition criteria, and level of application of both terms, thereby promoting a better understanding of the terms, improving identification and monitoring, and promoting consistency in the supervisory reporting and disclosures by banks. The definitions are intended to be used in the following contexts:</p> <ul style="list-style-type: none"> • Supervisory asset quality monitoring, including so that supervisory colleges can obtain a more consistent basis for comparison across jurisdictions; • Banks’ internal credit categorization systems for credit risk management purposes; • Pillar 3 disclosure on asset quality; • Dissemination of data for asset quality indicators; and, • As a reference point for other relevant working groups of the Basel Committee. <p>Further, it was observed that there is no detailed reporting on restructured loans. CBA staff indicated they are drafting a new report for this purpose. It is recommended that such reporting reflect the outcome of any decisions made regarding adoption of the Basel guidance</p> <p>The CBA requirements for provisions and reserves were established in 1999 and have not been revised significantly since that time. Assessors discussed this issue with bankers and external auditors and found that (i) it is a significant issue for banks to manage separate reporting systems for IFRS and CBA, and (ii) supervisory staff appear to take less interest in the IFRS 9 approaches to managing risk than the CBA requirements, even though the IFRS 9 approaches are used by banks to manage credit risk and develop information internally for decision making and establishing business objectives.</p> <p>While convergence with IFRS 9 and supervisory reporting may not be feasible, it is recommended that supervisors include an assessment of compliance with IFRS 9 standards as part of their overall evaluation of credit risk management practices.</p>
Principle 19	Concentration risk and large exposure limits. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate concentrations of risk on a timely basis. Supervisors set prudential limits to restrict bank exposures to single counterparties or groups of connected counterparties.⁴⁸
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have policies and processes that provide a comprehensive bank-wide view of significant sources of concentration risk. ⁴⁹ Exposures arising from off-balance sheet as well as on-balance sheet items and from contingent liabilities are captured.

⁴⁸ Connected counterparties may include natural persons as well as a group of companies related financially or by common ownership, management or any combination thereof.

⁴⁹ This includes credit concentrations through exposure to: single counterparties and groups of connected counterparties both direct and indirect (such as through exposure or collateral or to credit protection provided by a single counterparty), counterparties in the same industry, economic sector or geographic region and counterparties whose financial performance is dependent on the same activity or commodity as well as off-balance sheet exposures (including guarantees and other commitments) and also market and other risk concentrations where a bank is overly exposed to particular asset classes, products, collateral or currencies.

Description and findings re EC1	Regulation 4, Points 32 and 33 states that the banks should have a methodology to identify, measure, monitor and manage credit risk concentrations. The methodology should cover different types of credit risk concentrations, including: (i) by a single economic area, (ii) by a single geographic area, (iii) credit risk concentrations among the people whose financial conditions are depending on the price of the same product/service or who provide similar activity/act in the same market/adopt similar investment policy, (iv) large exposure provided to a natural person or affiliated parties, (v) indirect concentrations of credit risk, for example, by a same type of collateral, concentration by a single guarantor, etc. When calculating the prudential standards concerning concentration risk (see EC6), both on- and off-balance sheet items are taken into consideration.
EC2	The supervisor determines that a bank's information systems identify and aggregate on a timely basis, and facilitate active management of, exposures creating risk concentrations and large exposure ⁵⁰ to single counterparties or groups of connected counterparties.
Description and findings re EC2	Regulation 4, Point 31 defines that "the bank should implement a credit risk analysis for individual portfolios, identifying portfolio problems, including risk concentrations. Special attention should be paid to large exposures." The RBS Manual requires assessment by supervisors of the level of credit concentration by counterparties. During onsite examinations, CBA examiners review banks' policies and procedures on credit concentration, as part of their assessments of on credit risk.
EC3	The supervisor determines that a bank's risk management policies and processes establish thresholds for acceptable concentrations of risk, reflecting the bank's risk appetite, risk profile and capital strength, which are understood by, and regularly communicated to, relevant staff. The supervisor also determines that the bank's policies and processes require all material concentrations to be regularly reviewed and reported to the bank's Board.
Description and findings re EC3	Point 26 of Regulation 4 requires that "the bank's risk management system should address the risk appetite of the bank, approved by the Board, (i.e., risks that the bank is able and willing to accept without threatening its financial stability), individual risk management policies which define acceptable limits of the risk for each type of risk, and processes and tools for identification, assessment, mitigation, monitoring and reporting of individual risks". Point 15 defines that the bank should "ensure availability of its internal policies, describing its internal control system, to the bank's personnel". Point 92 of Regulation 4 states that reports concerning lending activity should be submitted to the Board and should <i>inter alia</i> include credit concentrations and large exposures. During onsite examinations, CBA examiners review banks' policies and procedures on credit concentration, as part of their assessments of credit risk.
EC4	The supervisor regularly obtains information that enables concentrations within a bank's portfolio, including sectoral, geographical and currency exposures, to be reviewed.
Description and findings re EC4	Regulation 3, paragraph 16 (form 14), requires banks to report large exposures monthly on a solo and a consolidated basis. Form 6 of Regulation 3 provides information on sectoral, maturity and currency distribution of loans on a monthly basis. The supervisors also use other sources of information such as the credit registry, to assess and monitor all exposures. Recently, the CBA has introduced a new reporting system which allows the supervisors to receive a wide range of "raw data" from banks that can be used for analytical purposes (this also enables supervisors to track geographical distribution of assets).

⁵⁰ The measure of credit exposure, in the context of large exposures to single counterparties and groups of connected counterparties, should reflect the maximum possible loss from their failure) i.e., it should encompass actual claims and potential claims as well as contingent liabilities). The risk weighting concept adopted in the Basel capital standards should be used in measuring credit exposure for this purpose as the relevant risk weights were devised as a measure of credit risk on basket basis and their use of measuring credit concentrations could significantly underestimate potential losses (see "Measuring and controlling large credit exposures, January 1991).

EC5	In respect of credit exposure to single counterparties or groups of connected counterparties, laws or regulations explicitly define, or the supervisor has the power to define, a “group of connected counterparties” to reflect actual risk exposure. The supervisor may exercise discretion in applying this definition on a case by case basis.
Description and findings re EC5	Article 8 of LBB has the qualifying criteria for “a group of connected parties” (see CP20). These criteria are sufficiently broad. The criteria also include a “deeming provision” where the CBA can use subjective criteria to apply the definition on a case by case basis. The CBA confirms its use of the deeming provision in practice.
EC6	Laws, regulations or the supervisor set prudent and appropriate ⁵¹ requirements to control and constrain large credit exposures to a single counterparty or a group of connected counterparties. “Exposures” for this purpose include all claims and transactions (including those giving rise to counterparty credit risk exposure), on-balance sheet as well as off-balance sheet. The supervisor determines that senior management monitors these limits and that they are not exceeded on a solo or consolidated basis.
Description and findings re EC6	Following a recent amendment giving the CBA flexibility to set the ratio and its elements, Article 44 of LBB defines the maximum risk on a single borrower as one of the prudential ratios set by the CBA. Regulation 2, paragraph 38.1, sets the limit for the definition of a large exposure at 5%. The maximum risk on a single borrower shall not exceed 20% of total capital and the aggregated risk on major borrowers shall not exceed 500% of total capital. The exposure includes on-balance sheet and off-balance sheet items (Regulation 2, paragraph 37). The regulation allows exposures on banks and foreign governments to be risk weighted (Regulation 2, paragraph 37) and allows government bonds of the Republic of Armenia to be excluded (Regulation 2, paragraph 46). Also, in some instances collateral may be considered (Regulation 2, paragraph 49). The CBA examiners monitor these limits on a regular basis using the offsite prudential returns and during onsite examinations.
EC7	The supervisor requires banks to include the impact of significant risk concentrations into their stress testing programs for risk management purposes.
Description and findings re EC7	Regulation 4, Chapter 6 specifies that banks should perform stress-testing for credit risk on a quarterly basis. Stress testing should form a part of the bank’s risk management process, promote the improvement of the quality of risk management and serve as an additional tool of risk management. The results of stress tests should affect the decision making of the bank’s managers and they should be used when defining the bank’s risk appetite or the limits on credit risk. Scenarios used for stress testing are forward-looking, extreme but probable, and allow assessing the bank’s sensitivity to shock conditions. In practice, all banks include their large exposure data into their stress tests. In addition, the CBA conducts its own stress tests for each bank, which also includes the data of the bank’s large exposures.
Additional criteria	
AC1	In respect of credit exposure to single counterparties or groups of connected counterparties, banks are required to adhere to the following: (a) ten per cent or more of the bank’s capital is defined as a large exposure; and (b) twenty-five per cent of a bank’s capital is the limit for an individual large exposure to a private sector non-bank counterpart or a group of connected counterparties. Minor deviations from these limits may be acceptable, especially if explicitly temporary or related to very small or specialized banks.

⁵¹ Such requirements should, at least for internationally active banks, reflect the applicable Base standards. As of September 2012, a new Basel standard on large exposures is still under consideration.

Description and findings re AC1	According to Regulation 5% or more of a bank's total capital is defined as a large exposure and 20% is the limit for an individual large exposure to a private sector counterparty or a group of connected counterparties. Deviations from these limits appear recurrent as confirmed to the assessors.
Assessment of Principle 19	Materially non-compliant
Comments	<p>The current large exposures regulation slightly deviates from Basel standards. Exposures to banks are risk weighted (Regulation 2, paragraph 37), and the ratio is calculated based on total regulatory capital and not based on the Tier 1 capital (BCBS standards on supervisory framework for measuring and controlling large exposures must be implemented in 1 January 2019 and CBA intends to do so). CBA explains that the second deviation was due to the legal definition of the ratio, before the recent amendment, which stated that it should be calculated based on the total capital. In this regard, a recent amendment to the LBB gives more flexibility to the CBA to decide on the level of capital to be used for calculation of the ratio, therefore it intends to eliminate the deviation in the near future. However, current deviations do not create a risk of misstatement, because the maximum level of the ratio is 20%, while Basel ratio is 25% and the large exposure definition is broader as it includes all exposures starting from the 5% of the regulatory capital, rather than 10%.</p> <p>Of concern, and warranting the materially non-compliant rating, are the number of banks that have been identified as breaching the large exposure limits. Although sanctions/fines have been levied in some cases, these have apparently not been sufficient to prevent further violations. Furthermore, the inconsistency in the application of sanctions for all breaches is problematic. The CBA should review its enforcement practices with regard to large exposure limits with an aim towards consistently applying sanctions and having banks operate within prescribed limits.</p>
Principle 20	Transactions with related parties. In order to prevent abuses arising in transactions with related parties⁵² and to address the risk of conflict of interest, the supervisor requires banks to enter into any transactions with related parties⁵³ on an arm's length basis; to monitor these transactions; to take appropriate steps to control or mitigate the risks; and to write off exposures to related parties in accordance with standard policies and processes
Essential criteria	
EC1	Laws or regulations provide, or the supervisor has the power to prescribe, a comprehensive definition of "related parties." This considers the parties identified in the footnote to the Principle. The supervisor may exercise discretion in applying this definition on a case by case basis.

⁵² Related parties can include, among other things, the bank's subsidiaries, affiliates, and any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank, the bank's major shareholders, Board members, senior management and key staff, their direct and related interests, and their close family members as well as corresponding persons in affiliated companies.

⁵³ Related party transactions include on-balance sheet and off-balance sheet credit exposures and claims, as well as, dealings such as service contracts, asset purchases and sales, construction contracts, lease agreements, derivative transactions, borrowings, and write-offs. The term transaction should be interpreted broadly to incorporate not only transactions that are entered into the related parties but also situations in which an unrelated party (with whom a bank has an existing exposure) subsequently becomes a related party.

Description and findings re EC1	Article 39 (2) of LBB states that the following parties shall be considered related to the bank: (i) the management of the bank, (ii) the parties with significant participation in the bank's capital, (iii) the parties related to and/or cooperating with parties listed in sub-points (i) and/or (ii) and (iv) the parties interrelated with the bank. The definition of interrelated parties is set by Article 8 of LBB, which identifies three types of connections: legal entity to legal entity, natural person to natural person and legal entity to natural person.	
	Related parties	CBA Regulation
	bank's subsidiaries	According to point 2 (d) of article 39 of the LBB the parties affiliated with the bank are considered to be related to the bank.
	any party (including their subsidiaries, affiliates and special purpose entities) that the bank exerts control over or that exerts control over the bank	Article 8 of the LBB defines the affiliation of entities, e.g. point 1 of article 8 defines affiliation of legal entities which includes subsidiaries, and any parties that the bank exerts control over or that exerts control over the bank.
	affiliates	According to point 2 (d) of article 39 of the LBB the parties affiliated with the bank are considered to be related to the bank.
	bank's major shareholders	According to point 2(b) of article 39 of the LBB the parties with significant participation in the bank's capital shall be considered related to the bank. Article 9 of the LBB defines the significant participation.
	Board members	According to point 2(a) of article 39 of the LBB the management of the bank shall be considered related to the bank. According to point 1 of article 22 of the LBB, board members, senior management and key staff are considered to be managers of the bank.
	senior management and key staff	
	their direct and related interests	According to point 2 (c) of article 39 of the LBB, the parties related to and/or cooperating with the management of the bank are considered to be related to the bank. According to point 2 of article 8 of the LBB, physical entities shall be considered related if they are members of the same family, or have common household, or jointly run business activities, or have been acting in accord aiming at common economic interests.
	their close family members	
corresponding persons in affiliated companies	No provision	
The internal sources of information include supervisory reports and the credit registry. Banks annually submit to the CBA reports on related parties. According to point 108 of Regulation 1 on statements provided to the CBA Statistical department before June 1 of each year for the residents, and before August 1 of each year for non-residents:		

	<ul style="list-style-type: none"> • financial statements of major shareholders of the bank and the foreign bank (in case of the branch of the foreign bank), for the last financial year and the opinion of their independent auditor, • financial statements of legal persons, affiliated with the bank and the foreign bank (in case of the branch of the foreign bank), for the last financial year and the opinion of their independent auditor, • names, surnames and positions of managers of legal persons, affiliated with the bank, as well as the legal persons, affiliated with the persons affiliated with the bank, • names, surnames and positions of natural persons, affiliated with the bank, as well as the natural persons, affiliated with the persons, affiliated with the bank. <p>During on-site inspections, supervisors have access to internal databases and documentation held by banks. To identify links between entities (shareholders, directors, subsidiaries), public registers are also used. As a rule, supervisors state that they keep professional skepticism when assessing the disclosure of related parties and their initial hypothesis is that related parties are not fully disclosed. For verification and identification of non-disclosed parties, supervisors review bank's transactions with possible interrelation with related parties. For sampling purposes, supervisors inter alia take into account factors like the nature of related parties (especially shareholders), the intention they could have when entering into transactions with the bank, etc. The assessment also includes review of those transactions that deviate from general quantitative and qualitative internal requirements set by a bank.</p> <p>The definition of related parties includes also principle-based statements. This gives the possibility of supervisory interpretation of the rule. According to Article 8, Paragraph 1(d) of LBB, the CBA is entitled to recognize a party related to the bank, and thereby subject the exposure to the prudential limits. Assessors have been provided with examples of recognition of an entity as related to the bank based on supervisory judgements.</p>
EC2	Laws, regulations or the supervisor require that transactions with related parties are not undertaken on more favorable terms (e.g., in credit assessment, tenor, interest rates, fees, amortization schedules, requirement for collateral) than corresponding transactions with non-related counterparties. ⁵⁴
Description and findings re EC2	According to Article 39(1) of the LBB, transactions executed with related parties of banks may not stipulate more beneficial terms and conditions for such parties (including a possibility for entering into a deal, a price, interests, maturity, etc.) than those applicable to individuals or legal entities that are not related parties. Moreover, transactions between the bank and any related party as specified in Part 1 of Article 34 of the LBB, shall be approved by the board of the bank upon the recommendation of its chief executive officer.
EC3	The supervisor requires that transactions with related parties and the write-off of related-party exposures exceeding specified amounts or otherwise posing special risks are subject to prior approval by the bank's Board. The supervisor requires that Board members with conflicts of interest are excluded from the approval process of granting and managing related party transactions.
Description and findings re EC3	Paragraph 1 of Article 39 of LBB requires that a bank's transactions with related parties should be subject to prior approval by the bank's board. Article 39(5) of LBB requires Board members with conflicts of interest to be excluded from the approval process.

⁵⁴ An exception may be appropriate for beneficial terms that are part of overall remuneration packages (e.g., staff receiving credit at favorable rates).

EC4	The supervisor determines that banks have policies and processes to prevent persons benefiting from the transaction and/or persons related to such a person from being part of the process of granting and managing the transaction.
Description and findings re EC4	Article 39(3) of LBB defines “concerned parties” as parties that have a conflict of interest. Concerned parties are “members of the Board, parties holding other positions in the bank’s management or the shareholders that together with interrelated parties hold 10 percent or more of the bank’s voting shares” if “they are a party of the transaction or agents or the representatives of the transaction or hold 20 or more percent of voting shares in the legal entity that is the party, agent or representative of the transaction, or hold positions in the management of the legal entity that is the party, agent or representative of the transaction”. According to Article 39.4 of LBB, concerned parties should inform the Board, internal audit, and external audit about their situation and are not entitled to participate in the process of decision making of the board or other relevant body of the bank regarding that transaction.
EC5	Laws or regulations set, or the supervisor has the power to set on a general or case by case basis, limits for exposures to related parties, to deduct such exposures from capital when assessing capital adequacy, or to require collateralization of such exposures. When limits are set on aggregate exposures to related parties, those are at least as strict as those for single counterparties or groups of connected counterparties.
Description and findings re EC5	According to Regulation 2, paragraphs 22 and 23, exposures to one related party shall not exceed 5% of total capital and exposure to all related parties shall not exceed 20% of the total capital of a bank. These limits are stricter than those for single counterparties (20% and 500% respectively). The exposure amount refers to the amount of loans to a bank related party, including “lending to a bank account, all other borrowings, factoring and leasing operations, advances, prepayments, installments for bank service or products, letters of credit, investments in securities issued by the party or related parties, (including bills), correspondent accounts and deposits of the bank, receivables, repo agreements, claims on currency swaps, as well as any other liabilities to the bank, including sureties and guarantees issued to another party for liabilities to the same bank, any other cover funds (by the amount not exceeding the secured total liability), sureties and guarantees for the liabilities of the bank related party, borrowings and guarantees to the same party provided by other banks on account of, and secured by, monetary assets of the bank (provided that the bank assumed the risk to collect such borrowings), off-balance sheet contingent liabilities, containing credit risk”. There is no requirement to deduct such exposures from capital when assessing capital adequacy, nor the excess of such exposures above the regulatory limits.
EC6	The supervisor determines that banks have policies and processes to identify individual exposures to and transactions with related parties, as well as the total amount of exposures, and to monitor and report on them through an independent credit review or audit process. The supervisor determines that exceptions to policies, processes and limits are reported to the appropriate level of the bank’s senior management and, if necessary, to the Board, for timely action. The supervisor also determines that senior management monitors related party transactions on an ongoing basis, and that the Board also provides oversight of these transactions.
Description and findings re EC6	Point 85 of Regulation 4 requires that the bank’s internal control system address principles of lending to related parties. According to point 92, reports submitted to the bank’s Board and executive body concerning the bank’s lending activity should include information about the loans provided to related parties. Point 127 requires effective procedures of collecting, maintaining (archiving) and updating information about related parties, as well as effective procedures for disclosing and overseeing possible cases of conflicts of interests. Information about related parties should at least include, inter alia, all kinds of loans, borrowings, investments, collateral, contingent and other liabilities, deposits from the bank, borrowings

	given to the bank, etc. (Regulation 4, point 130). The LBB (Article 39, paragraph 1) requires that the Board approve all financial operations with related parties.
EC7	The supervisor obtains and reviews information on aggregate exposures to related parties
Description and findings re EC7	Regulation 3 requires banks to submit the information on single borrowers and bank related persons on a monthly basis. Banks also submit reports on aggregated lending to connected and related parties.
Assessment of Principle 20	Largely Compliant
Comments	<p>Current legislation and regulations require banks to have policies and procedures in place that set out their approach to entering into exposures to connected parties. Improvements in the CBA monitoring since 2012 cover the following: (i) introduction of reporting requirement on intragroup transactions (these include not only transactions between group members, but also between the members and their related parties) as part of the consolidated supervision framework, (ii) CBA powers to establish limits on intragroup transactions up to 0%, i.e., prohibit these transactions, (iii) Disclosure according to Reg 8/03 and international accounting standards.</p> <p>However, as only very few full scope on-site examinations have been performed in the last 5 years, the CBA should consider undertaking a thematic review of related party lending reporting to ensure that banks and banking groups are capturing all connected loans under the current legislation.</p> <p>In addition, as there is no requirement to deduct the excess of such exposures above the regulatory limits from capital when assessing capital adequacy, it might be considered when updating the regulations after the proposed review providing the supervisor such power in case of breaches.</p>
Principle 21	Country and transfer risks. The supervisor determines that banks have adequate policies and processes to identify, measure, evaluate, monitor, report and control or mitigate country risk⁵⁵ and transfer risk⁵⁶ in their international lending and investment activities on timely basis.
Essential criteria	
EC1	The supervisor determines that a bank's policies and processes give due regard to the identification, measurement, evaluation, monitoring, reporting and control or mitigation of country risk and transfer risk. The supervisor also determines that the processes are consistent with the risk profile, systemic importance and risk appetite of the bank, take into account market and macroeconomic conditions and provide a comprehensive bank-wide view of country and transfer risk exposure. Exposures (including, where relevant, intra-group exposures) are identified, monitored and managed on a regional and individual country basis (in addition to the end-borrower/end-counterparty basis). Banks are required to monitor and evaluate developments in country risk and in transfer risk and apply appropriate countermeasures.

⁵⁵ Country risk is the risk of exposure to loss caused by events in foreign country. The concept is broader than sovereign risk as all forms of lending or investment activity whether to/with individuals, corporate, banks or governments are covered.

⁵⁶ Transfer risk is the risk that a borrower will not be able to convert local currency into foreign exchange and so will be unable to make debt service payments in foreign currency. The risk normally arises from exchange restrictions imposed by the government in the borrower's country. (Reference document: *IMF paper on External Debt Statistics—Guide for compilers and users, 2003.*)

Description and findings re EC1	<p>Until recently, the regulatory framework was addressing country risk as part of the general credit risk framework. Point 32 of Regulation 4 defines that the bank should have a methodology to identify, measure, monitor and manage credit risk concentration, including those by a single geographic area. In addition, point 85 specifies that the bank's internal control system, concerning its lending activity, should "at least include the limits of credit concentrations, including by those countries with whom or with the residents of which the bank implements operations." These policies and procedures shall be approved by the bank's Board.</p> <p>Reg. 4 has been modified and effective June 1, 2018, a new approach to country risks has been adopted, including a requirement for banks to rate their countries of exposure. New Points 55.1 to 55.4 of Reg.4, as amended in March 2018 (effective June 1, 2018), set specific requirements about credit risk management and monitoring. Country risk is defined as "the likelihood of adverse effect of any economic, social and (or) political conditions or events in the concerned country on the bank's risk profile, liquidity and (or) profit." Banks should have in place an appropriate system, including a rating system for the countries with the residents of which the bank or the bank's customers conduct such financial operations, which are significant for the bank from the perspective of country risk. The banks are required to set limits for such operations. Moreover, the limits should be revised at least annually. In practice, Armenian banks do not have significant exposures to country risk (2% of their total assets). The exposures arise from nostro accounts and loans to non-resident entities. The majority of correspondent banks of Armenian banks are located in the USA, Austria and Germany.</p>
EC2	<p>The supervisor determines that bank' strategies, policies and processes for the management of country and transfer risks have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.</p>
Description and findings re EC2	<p>As stated in EC 1, Reg. 4 as amended requires banks to develop a methodology to identify, measure, monitor and manage country risks and to set limits that should be adopted by the bank's Board. At the same time, in accordance with LBB, the executive director is responsible for ensuring implementation of decisions of the Board.</p> <p>Regulation 4, point 9 states" that the bank's Board, executive body, oversight functions, all bank's employees within their responsibilities, defined by laws and/or other legal acts, are responsible for formulation, operation and effective continuous monitoring of the bank's internal control system."</p>
EC3	<p>The supervisor determines that banks have information systems, risk management systems and internal control systems that accurately aggregate, monitor and report country exposures on a timely basis; and ensure adherence to established country exposure limits.</p>
Description and findings re EC3	<p>As per 2014 amendments to Regulation 4 all concentrations must be reported to the Board. This includes geographical concentrations. During onsite examinations, supervisors ensure that information systems are adequate and timely.</p> <p>Reg. 3 defines the content of reporting Form # 3 (reporting by banks of their interbank exposures by country). Supervisors also have access to the detail of depositors and borrowers by country of residence.</p>
EC4	<p>There is supervisory oversight of the setting of appropriate provisions against country risk and transfer risk. There are different international practices that are all acceptable as long as they lead to risk-based results. These include:</p> <ul style="list-style-type: none"> (a) The supervisor (or some other official authority) decides on appropriate minimum provisioning by regularly setting fixed percentages for exposures to each country taking into account prevailing conditions. The supervisor reviews minimum provisioning levels where appropriate. (b) The supervisor (or some other official authority) regularly sets percentage ranges for each country, taking into account prevailing conditions and the banks may decide, within these

	<p>ranges, which provisioning to apply for the individual exposures. The supervisor reviews percentage and ranges for provisioning purposes where appropriate.</p> <p>(c) The bank (or some other body such as the national bankers association) sets percentages or guidelines for the appropriate provisioning. The adequacy of the provisioning will then be judged by the external auditor and/or by the supervisor.</p>
Description and findings re EC4	The new regulation does not set specific requirements on provisioning for country risk exposures. However, under the prudential regulation on provisioning, at the origination of assets, banks must make at least 1% loss provisions to the general loan loss reserve. CBA considers that the 20% higher provisions for FX exposures might partially/indirectly cover the country risk and does not have specific provisions for this type of risk which is considered low for Armenia.
EC5	The supervisor requires banks to include appropriate scenarios into their stress testing programs to reflect country and transfer risk analysis for risk management purposes.
Description and findings re EC5	A new provision (Reg.4, point 70.7) requires banks to include country risk in their stress-testing from June 1, 2018.
EC6	The supervisor regularly obtains and reviews sufficient information on a timely basis on the country risk and transfer risk of banks. The supervisor also has the power to obtain additional information, as needed (e.g., in crisis situations).
Description and findings re EC6	The CBA has developed a reporting system that enables receiving information on all types of exposures to non-resident counterparties on a monthly basis: the CBA receives a very detailed description of non-resident counterparties, including the name of the country of residence. At the same time, point 31 of Regulation 3 defines that the supervisor is entitled to request any additional information and clarification from the bank upon the need to get explanations and clarifications on certain points in the report or for certain supervision purposes.
Assessment of Principle 21	Largely Compliant
Comments	<p>A specific framework on country risk monitoring (definition, rating, limits) is in place since June 1, 2018. Therefore, assessors still need to see evidence of implementation through off-site and on-site examinations.</p> <p>Based on its monitoring, the CBA considers country risk to be relatively low for the Armenian banking system, therefore it has not been of high priority for the authorities. CBA has however introduced a range of general requirements to the risk management function of banks in assessing, monitoring and managing different types of risk not included in Pillar 1, including country risk.</p>
Principle 22	Market risk. The supervisor determines that banks have an adequate market risk management process that takes into account their risk appetite, risk profile, and market and macroeconomic conditions and the risk of a significant deterioration in market liquidity. This includes prudent policies and processes to identify, measure, evaluate, monitor, report and control or mitigate market risks on a timely basis.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have appropriate market risk management processes that provide a comprehensive bank-wide view of market risk exposure. The supervisor determines that these processes are consistent with the risk appetite, risk profile, systemic importance and capital strength of the bank; take into account market and macroeconomic conditions and the risk of a significant deterioration in market liquidity; and clearly articulate the roles and responsibilities for identification, measuring, monitoring and control of market risk.

Description and findings re EC1	<p>In accordance with Regulation 2, Appendix 4, market risk capital charges include equity risk, interest rate risk and foreign exchange risk. Market risk capital charges currently represent on average 7 percent of total capital versus 3.4 percent at the 2012 assessment. Interest rate risk in the trading book comprises most of the increase.</p> <p>The primary sources of market risk in Armenia are interest rate risk in the trading book, FX, and price risk of equity securities. The evaluation of the three elements of market risk (IRR, FX, pricing) is conducted using the RBS approach. Analysis of inherent risks is intended to assess whether the material operations of the bank that have market risk exposures have the potential to present meaningful losses to either the firm or the banking system generally. The risk assessment process factors in the potential impact of market conditions or disruptions, a bank's systemic importance, and its's overall financial strength.</p> <p>For market risk specifically, the assessment of inherent risk includes the following:</p> <p>Interest Rate Risk:</p> <ol style="list-style-type: none"> 1) Size of the asset liability position containing IRR. 2) Risk of maturity/repricing differences 3) Basis risk 4) Instrument option risk 5) Type of rate offered 6) Geographic area of circulation of the instrument 7) Currency structure 8) Concentrations (by maturity, rate, geography, etc.) 9) Changes in the instrument's liquidity <p>Foreign Exchange Risk</p> <ol style="list-style-type: none"> 1) Size and liability position containing FX risk 2) Changes in amounts of loans and deposits 3) Exchange rate regime (floating, fixed) 4) Other factors that may affect FX position <p>Price Risk of Equity Securities</p> <ol style="list-style-type: none"> 1) Geographic area of circulation of the equity security 2) Existence of a market maker for the security 3) General information on changes in the issuer 4) Size of market; supply and demand for the securities 5) Cyclical phase of the economy (Inflation/deflation) 6) Changes in the liquidity of the instrument. <p>In accordance with Chapter 4 of Regulation 4, banks must have internal regulations, approved by the Board regarding processes and tools (including the models (if applicable)) of identification, measurement, mitigation, monitoring and reporting of market risk, as well as duties and authorities of the bank's individual business units and employees, involved in the risk management process. These internal regulations must be submitted to the CBA after their approval. Depending on the level of the bank's exposure to market risk, the internal process of risk assessment can be based on Value-at-Risk or other models and/or results of stress-tests, including the assessment of risk concentrations and the risk of liquidity problems in stressful market conditions.</p> <p>When CBA supervisors conduct onsite examinations, they verify that these policies and procedures which are adopted by the Board are actually implemented—i.e., that the staff of the bank is aware of these rules and that the Board and Senior Management have appropriate oversight using effective management information systems. The assessors conducted</p>
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	interviews with risk team members and discussed their findings to determine that a bank's implementation of policies and procedures is verified during an examination.
EC2	The supervisor determines that banks' strategies, policies and processes for the management of market risk have been approved by the banks' Boards and that the Boards oversee management in a way that ensures that these policies and processes are implemented effectively and fully integrated into the banks' overall risk management process.
Description and findings re EC2	See EC 1.
EC3	The supervisor determines that the bank's policies and processes establish an appropriate and properly controlled market risk environment including: <ul style="list-style-type: none"> (a) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of market risk exposure to the bank's Board and senior management; (b) appropriate market risk limits consistent with the bank's risk appetite, risk profile and capital strength, and with the management's ability to manage market risk and which are understood by, and regularly communicated to, relevant staff; (c) exception tracking and reporting processes that ensure prompt action at the appropriate level of the bank's senior management or Board, when necessary; (d) effective controls around the use of models to identify and measure market risk, and set limits; and (e) sound policies and processes for allocation of exposures to the trading book.
Description and findings re EC3	<p>Chapter 4 of Regulation 4 requires that banks have a market risk management policy which should include the process and tools of identification, measurement, mitigation, monitoring and reporting of market risk. The reports should be submitted to the Board and executive management. The bank's Board is responsible for the development of a functioning risk management system and ensuring continuous monitoring of its effectiveness. The executive body is responsible for effective implementation of risk management system, as well as ensuring the effective circulation of procedures and other internal policies, approved by the Board, within the whole bank. Point 26(3)(b) of Regulation 4 requires the banks to define the acceptable limits of market risk, as well as the cases and sizes of allowed deviations from the defined limits. In addition, the bank should ensure availability of its internal policies, describing its internal control system, to the bank's personnel. Point 56 specifies that any operation that results in an unauthorized deviation from the risk management strategy, risk appetite and/or risk limits, approved by the bank's Board, should be discussed in detail and presented for the Board's approval.</p> <p>Point 37 of Regulation 4 specifies that depending on the level of the bank's exposure to market risk, the internal process of risk assessment can be based on Value-at-Risk or other models and/or results of stress-tests, including the assessment of risk concentrations and the risk of liquidity problems in the stressful market conditions. The implemented models should give an opportunity to identify and measure the risk. In case of changes to the bank's trading instruments, as well as the strategy of commercial transactions implementation, the methodologies under the risk measurement models and/or stress tests should also be appropriately changed.</p> <p>In addition, point 58 of Regulation 4 defines that risk management processes should be periodically revised to ensure promptness and validity of the process. The main areas, subject to revision, should include validity and completeness of input data, used during the assessment of the bank's level of risk, as well as testing and analysis of the assumptions.</p> <p>The controls over the market risk environment are evaluated through targeted inspections determined through the annual risk assessment process. The risk team uses balance sheet,</p>

	prudential ratios, results from bank internal models, cash flow forecasts, and stress tests to monitor trading and banking book activities. On-site market/liquidity risk reviews are scheduled for six banks this year.
EC4	The supervisor determines that there are systems and controls to ensure that bank's marked-to-market positions are revalued frequently. The supervisor also determines that all transactions are captured on a timely basis and that the valuation process uses consistent and prudent practices, and reliable market data verified by a function independent of the relevant risk-taking business units (or, in the absence of market prices, internal or industry-accepted models). To the extent that the bank relies on modeling for the purposes of valuation, the bank is required to ensure that the model is validated by a function independent of the relevant risk-taking businesses units. The supervisor requires banks to establish and maintain policies and processes for considering valuation adjustments for positions that otherwise cannot be prudently valued, including concentrated, less liquid, and stale positions.
Description and findings re EC4	<p>In accordance with the Law on Accounting, banks are required to comply with IFRS, which includes the rules and methods for proper revaluation of mark-to-market positions. In addition, Regulation 4 regarding internal models was amended in June 2018 to require a bank to "identify and minimize the risks arising from incorrect description of parameters, incorrect assessments, incomplete hypotheses and (or) assumptions, errors in mathematic calculations used in the model, and inadequate monitoring and (or) control." The banks policies and processes should include:</p> <ol style="list-style-type: none"> 1) Assessment of the need for developing a model, 2) Model development, 3) Model assessment, 4) Model approval, 5) Regular monitoring of the model, including its testing based on historical data (at least annually), 6) As necessary, making changes and adjustments to the model. <p>During on-site visits the supervisors review internal information systems and the assessment of external auditors to ensure that all transactions are captured on a timely basis, reliable market data is used, and all material concerns are reported to the Board and Senior management. Assessors were unable to assess compliance with the recently enacted regulation change due to its recency.</p>
EC5	The supervisor determines that banks hold appropriate levels of capital against unexpected losses and make appropriate valuation adjustments for uncertainties in determining the fair value of assets and liabilities.
Description and findings re EC5	<p>Regulation 2 sets limits for market risk, which includes equity risk, interest rate risk and foreign exchange risk.</p> <p>For interest rate risk, the capital charge methodology is based on the 2006 Basel II Framework requirements. The minimum capital requirement is expressed in terms of two separately calculated charges, one applying a "specific risk" of each security and the other to IRR in the portfolio termed "general market risk."</p> <p>The CBA risk weights for specific risk are higher than the Basel II requirements, in particular for government securities.</p> <p>For general market risk, CBA uses the maturity method in which long or short positions in debt securities and other sources of interest rate exposures are slotted into a maturity ladder comprising thirteen time-bands. Fixed rate instruments are allocated according to the residual term to maturity and floating-rate instruments according to the residual term to the next repricing date. Again, risk weights assigned to each of these maturity bands equal or exceed Basel II standards.</p>

	<p>CBA should evaluate the January 2016 BCBS Standards, "Minimum Capital Requirements for Market Risk" and the June consultative document "Simplified alternative to the standardized approach to market risk capital requirements." While CBA is considered in compliance with 2006 Basel II standardized approaches, there is some concern that those standards may not be sufficiently dynamic to address the growth in interest rate risk. In addition to evaluating the 2016 changes, the CBA should better integrate IRR stress testing into Pillar 2 capital requirements.</p> <p>For FX risk capital calculations, banks can apply the standardized methodology or a VaR methodology. For banks using the standardized approach, the foreign exchange risk capital charge is 12% of the maximum FX position. For banks using the VaR methodology, it shall be calculated based on a 99% level of confidence and a 10-day horizon. These limits are mandatory for all banks, though banks' boards may set internal limits for their own risk management process.</p> <p>The CBA evaluates monthly reports on a bank's market risk. In addition, the CBA has established two currency disposition ratios. The maximum open position per currency is 7% of total capital and the sum of the absolute value of all open positions is maximum 10% of total capital.</p>
EC6	The supervisor requires banks to include market risk exposure into their stress testing programs for risk management purposes.
Description and findings re EC6	Under Chapter 6 of Regulation 4, banks should perform stress testing for FX risk, interest rate risk and price risk. Stress testing for interest rate risk and price risk is performed at least on a quarterly basis, and stress testing for FX risk is performed on a monthly basis. Stress testing is intended as a part of the bank's risk management process and the results of stress tests are reviewed for their impact on decision making regarding risk appetite or limits on market risk. Banks should develop their own stress scenarios. For the banks that have large amounts of other foreign currencies, stress tests for depreciation and/or appreciation of the Armenian dram against such currencies are also performed.
Assessment of Principle 22	Largely Compliant
Comments	<p>Regulation 4 sets minimum requirements which address the basic aspects of market risk management. Initially it was developed on the basis of Basel recommendations and EU legislation taking into account the complexity and risk profiles of banks. As currently structured, it sets high level principles that need to be interpreted for effective implementation.</p> <p>Several on-site inspections are planned which will address market risk practices. One of the objectives is to assess the level of compliance of banks' current practices with BCBS recommendations and to assess the need for possible revisions to the regulatory standards. After completion of on-site inspections in several (major) banks the revision of existing regulatory standards will be prepared. It is recommended that revisions to address identified gaps be completed by mid-2019.</p> <p>Market risk capital charges currently represent on average 7 percent of total capital versus 3.4 percent at the 2012 assessment. Interest rate risk in the trading book comprises most of the increase. CBA should evaluate the January 2016 BCBS Standards, "Minimum Capital Requirements for Market Risk" and the June consultative document "Simplified alternative to the standardized approach to market risk capital requirements." While CBA is considered in compliance with 2006 Basel II standardized approaches, there is some concern that those standards may not be sufficiently dynamic to address the growth in interest rate risk. In addition to evaluating the 2016 changes, the CBA should better integrate IRR stress testing into Pillar 2 capital requirements.</p>

	<p>A considerable amount of work has been ongoing to build the market risk/liquidity team. Supervisors have been detailed to other supervisory agencies to study best practices and training seminars on market risk topics are offered. The risk team provides support to the general supervisors on a continuous basis by answering questions and conducting ad hoc analysis. Thematic reviews are being used to build a knowledge base around market risk management practices. The team is also enhancing market risk review procedures for general supervisors. Staff knowledge regarding market risk within the risk team appears generally adequate to assess market risks in the banking sector.</p> <p>As noted under EC. 4, no assessment was made of supervisory reviews for compliance with the new regulations for internal models due to its recency.</p>
Principle 23	Interest rate risk in the banking book. The supervisor determines that banks have adequate systems to identify, measure, evaluate, monitor, report and control or mitigate interest rate risk⁵⁷ in the banking book on a timely basis. These systems take into account the bank's risk appetite, risk profile and market and macroeconomic conditions.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have an appropriate interest rate risk strategy and interest rate risk management framework that provides a comprehensive bank-wide view of interest rate risk. This includes policies and processes to identify, measure, evaluate, monitor, report and control or mitigate material sources of interest rate risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank, take into account market and macroeconomic conditions, and are regularly reviewed and appropriately adjusted, where necessary, with the bank's changing risk profile and market developments.
Description and findings re EC1	<p>Chapter 4 of Regulation 4 requires that banks have an effective system of risk management, approved by the Board, which addresses, at a minimum, the risk management strategy, risk appetite of the bank, and individual risk management policies across a broad spectrum of risks, including interest rate risk. Risk management policies must define acceptable limits of risk, allowable deviations from the defined limits, and the internal processes for identification, assessment, mitigation, monitoring and reporting of risk. The regulation also requires a description of the duties and authorities of the bank's individual business units and employees involved in risk management process, as well as a process for review by the Board.</p> <p>More specifically, Regulation 4, paragraphs 95 and 96, set minimum requirements for asset-liability management. These include requirements for diversification, setting target levels for interest margins, limits for off-balance sheet items sensitive to interest rate changes, establishing procedures for setting interest rates on deposits and other liabilities, and permissible limits of maturity gap of the bank's assets and liabilities.</p> <p>Banks report on maturities of assets and liabilities (Regulation 3, Form 9) monthly, and average interest rates on funds attracted each week (Form 17). The CBA conducts a review of all policies and procedures described in the bank's internal policies via both off-site review (all internal policies and revisions are submitted to the supervisor), as well as through on-site targeted examinations to determine that strategy, policies and processes are consistent with the risk appetite, risk profile and systemic importance of the bank.</p>
EC2	The supervisor determines that a bank's strategy, policies and processes for the management of interest rate risk have been approved, and are regularly reviewed, by the bank's Board. The

⁵⁷ Wherever "interest rate risk" is used in this Principle the term refers to interest rate risk in the banking book. Interest rate risk in the trading book is covered under Principle 22.

	supervisor also determines that senior management ensures that the strategy, policies and processes are developed and implemented effectively.
Description and findings re EC2	Yes, see EC 1.
EC3	<p>The supervisor determines that banks' policies and processes establish an appropriate and properly controlled interest rate risk environment including:</p> <ul style="list-style-type: none"> (a) comprehensive and appropriate interest rate risk measurement systems; (b) regular review, and independent (internal or external) validation, of any models used by the functions tasked with managing interest rate risk (including review of key model assumptions); (c) appropriate limits, approved by the banks' Boards and senior management, that reflect the banks' risk appetite, risk profile and capital strength, and are understood by, and regularly communicated to, relevant staff; (d) effective exception tracking and reporting processes which ensure prompt action at the appropriate level of the banks' senior management or Boards where necessary; and (e) effective information systems for accurate and timely identification, aggregation, monitoring and reporting of interest rate risk exposure to the banks' Boards and senior management.
Description and findings re EC3	<p>With regard to risk areas generally and including IRRBB, supervisors are required to assess the comprehensiveness of risk measurement systems, the processes for reviewing and validating models, compliance with established limits, exception reporting and the adequacy of reporting to the Board and senior management. These requirements are found in the criteria for assessing governance quality in the RBS manual. Annually, through the risk assessment process, supervisors assess the control functions of the bank, including the quality of operational management, control functions (compliance/risk management) senior management, and the Board. Where gaps are identified, plans are developed for conducting supervisory activities.</p> <p>With regard to interest rate risk, particularly in banks with higher risk profiles, supervisory plans are geared towards the review of these control areas to fill knowledge gaps in the current cycle. Activities include targeted work from both institution specific teams as well as the Market/Liquidity Risk team.</p> <p>Procedures/questionnaires are also under development by the risk team with IRRBB responsibilities to enhance guidance for banks and supervisors, including requirements outlined in the BCBS 2016 IRRBB guidance.</p>
EC4	The supervisor requires banks to include appropriate scenarios into their stress testing programs to measure their vulnerability to loss under adverse interest rate movements.
Description and findings re EC4	Under Chapter 6 of Regulation 4, banks should perform a range of stress tests, including for interest rate risk in the banking book. Stress testing for interest rate risk should be performed at least on a quarterly basis. Stress testing should form a part of the bank's risk management process and the results of stress tests should inform decision making of the bank's management when defining the bank's risk appetite. Banks should develop their own stress scenarios. In addition, banks have also been provided with various stress scenarios for interest rate risk by the CBA. These include the standardized Basel 2% interest rate shock. The calculation is performed using both the economic value (duration), whereby the change in the economic value of the bank's capital is estimated under this scenario and earnings-based NII method.
Additional criteria	

AC1	The supervisor obtains from banks the results of their internal interest rate risk measurement systems, expressed in terms of the threat to economic value, including using a standardized interest rate shock on the banking book.
Description and findings re AC1	Regulation 3 requires the banks to submit the results of their stress tests (including interest rate risk stress tests) to the Central Bank.
AC2	The supervisor assesses whether the internal capital measurement systems of banks adequately capture interest rate risk in the banking book.
Description and findings re AC2	Chapter 5 of Regulation 4 defines that the bank's executive body is responsible for developing the ICAAP, defining a benchmark level of capital, adequate to the bank's risk profile and risk management environment, as well as implementing a system for matching the bank's capital level with its risks (including interest rate risk in the banking book). As a part of the bank's risk management system, the banks should implement an internal capital adequacy assessment process at least on a quarterly basis, which should be consistent with the nature, volume and complexity of risks on the bank's activities.
Assessment of Principle 23	Largely Compliant
Comments	The CBA guidance for banks to monitor and manage IRRBB is rudimentary but has enabled the CBA to monitor interest rate satisfactorily. In addition to broad risk management principles, there are requirements related to overall asset/liability management that include identification of interest rate gaps and establishment of limits. However, the CBA should evaluate the need to incorporate, as appropriate to their jurisdiction, the recommendations in the 2016 Basel Standards for IRRBB. The 2016 standards provide more guidance on the development of interest rate shock scenarios and key behavioral and modeling assumptions; enhanced disclosure requirements; an update to the standardized framework; and stricter thresholds for identifying outlier banks.
Principle 24	Liquidity risk. The supervisor sets prudent and appropriate liquidity requirements (which can include either quantitative or qualitative requirements or both) for banks that reflect the liquidity needs of the bank. The supervisor determines that banks have a strategy that enables prudent management of liquidity risk and compliance with liquidity requirements. The strategy takes into account the bank's risk profile as well as market and macroeconomic conditions and includes prudent policies and processes, consistent with the bank's risk appetite, to identify, measure, evaluate, monitor, report and control or mitigate liquidity risk over an appropriate set of time horizons. At least for internationally active banks, liquidity requirements are not lower than the applicable Basel standards.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to consistently observe prescribed liquidity requirements including thresholds by reference to which a bank is subject to supervisory action. At least for internationally active banks, the prescribed requirements are not lower than, and the supervisor uses a range of liquidity monitoring tools no less extensive than, those prescribed in the applicable Basel standards.
Description and findings re EC1	Regulation 2 defines the liquidity ratios that are mandatory for banks in Armenia. The prudential ratios are the same for all banks. Banks calculate prudential liquidity ratios on a monthly basis. The requirements are as follows: <ul style="list-style-type: none"> • The ratio of highly liquid assets to total assets (general liquidity) should not be lower than 15%,

	<ul style="list-style-type: none"> The ratio of highly liquid assets to demand liabilities (current liquidity) should not be lower than 60%. <p>In 2013, prudential FX liquidity ratios were introduced. Banks are required to calculate the abovementioned ratios for currencies included in Group 1. The thresholds are set at 4% and 10%, respectively. Group 1 includes SDRs, the SDR basket currencies, Swiss franc, Canadian dollar, Swedish krona, Danish krone, Australian dollar and banking gold.</p> <p>Group 2 includes all other foreign currencies. In cases when liabilities expressed in any Group 2 foreign currency exceed 5% of a bank's total liabilities, the bank shall calculate the abovementioned liquidity ratios for Group 2 currency.</p> <p>Also, as part of the liquidity management process, banks are required to identify potential sources of liquidity, set limits on concentrations of funding sources, diversify loans by repayment periods, develop programs to meet any additional requirements of liquidity, and conduct liquidity stress testing. (Regulation 4, points 70, 71 95, 96).</p> <p>Currently, banks calculate LCR and NSFR ratios on a monthly basis and report them to the CBA, however, these ratios have not been formally adopted by the CBA, as discussed more fully in the comments section. The methodologies for LCR and NSFR calculation are based on the requirements established by the BCBS.</p>
EC2	The prescribed liquidity requirements reflect the liquidity risk profile of banks (including on- and off-balance sheet risks) in the context of the markets and macroeconomic conditions in which they operate.
Description and findings re EC2	The prescribed liquidity requirements were developed to address the significant liquidity risks associated with Armenia's highly dollarized economy. While these requirements are generally appropriate given the risk profile of banks, the CBA intends to adopt an LCR and NSFR framework.
EC3	The supervisor determines that banks have a robust liquidity management framework that requires the banks to maintain sufficient liquidity to withstand a range of stress events and includes appropriate policies and processes for managing liquidity risk that have been approved by the banks' Boards. The supervisor also determines that these policies and processes provide a comprehensive bank-wide view of liquidity risk and are consistent with the banks' risk profile and systemic importance.
Description and findings re EC3	<p>Regulation 4 requires banks have risk management and internal control systems for liquidity management that address: the sources of funding available to meet the bank's liquidity requirements, limits on concentrations of funding sources, criteria for selecting alternative sources of liquid funds in cases when the primary sources are unavailable, permissible limits of the maturity gap of the bank's assets and liabilities, requirements to regularly perform liquidity risk stress-tests, and requirements to provide an action plan based on stress-test results. The risk management and internal control systems should be approved by the Board of the bank.</p> <p>Annually, a comprehensive assessment of liquidity is made as part of the RBS risk assessment process. At a minimum, the assessment covers the adequacy of liquidity based on financial metrics (prudential standards compliance, asset/liability structure term and currency structure, systemic impact of firm); management organizational structure, policies and procedures; resources within the liquidity management function; reporting systems; and quality assurance. Based on that assessment, supervisory activities are planned to evaluate potential risks and address any knowledge gaps. Off-site, there is an ongoing process to review submitted regulatory reports and stress tests, as well as the contingency liquidity plan that accompanies the stress tests.</p>
EC4	The supervisor determines that banks' liquidity strategy, policies and processes establish an appropriate and properly controlled liquidity risk environment including:

	<ul style="list-style-type: none"> (a) clear articulation of an overall liquidity risk appetite that is appropriate for the banks' business and their role in the financial system and that is approved by the banks' Boards; (b) sound day-to-day, and where appropriate intraday, liquidity risk management practices; (c) effective information systems to enable active identification, aggregation, monitoring and control of liquidity risk exposures and funding needs (including active management or collateral positions) bank-wide; (d) adequate oversight by the banks' Boards in ensuring that management effectively implements policies and processes for the management of liquidity risk in a manner consistent with the banks' liquidity risk appetite; and (e) regular review by the banks' Boards (at least annually) and appropriate adjustment of the banks' strategy, policies and processes for the management of liquidity risk in the light of the banks' changing risk profile and external developments in the markets and macroeconomic conditions in which they operate.
Description and findings re EC4	<p>The RBS required risk assessment and subsequent scheduled supervisory activities address the following:</p> <ul style="list-style-type: none"> (a) Adequacy of the liquidity risk tolerance to the FO's (financial organization) performance objectives and key areas of long-term development; (b) Adequacy of the liquidity risk management organizational structure and practices; (c) Adequacy of reporting systems; (d) Adequacy of resources; (e) Adequacy of quality control and (f) Role of the Board in reviewing and reassessing the appropriateness of the risk appetite and the risk management structure. <p>Assessors reviewed a sample of risk assessment matrices, examination scoping materials and supervisory letters, as well as regular (monthly/quarterly) memoranda to supervisory management with the assistance of field examiners and verbal translations. The documentation demonstrated that supervisory activities are adequate to determine the effectiveness of the control environment.</p>
EC 5	<p>The supervisor requires banks to establish, and regularly review, funding strategies and policies and processes for the ongoing measurement and monitoring of funding requirements and the effective management of funding risk. The policies and processes include consideration of how other risks (e.g., credit, market, operational and reputation risk) may impact the bank's overall liquidity strategy, and include:</p> <ul style="list-style-type: none"> (a) an analysis of funding requirements under alternative scenarios; (b) the maintenance of a cushion of high quality, unencumbered, liquid assets that can be used, without impediment, to obtain funding in times of stress; (c) diversification in the sources (including counterparties, instruments, currencies and markets) and tenor of funding, and regular review of concentration limits; (d) regular efforts to establish and maintain relationships with liability holders; and regular assessment of the capacity to sell assets.
Description and findings re EC5	<p>According to Chapter 4 of Regulation 4, banks should develop a valid risk assessment system for liquidity risk, which includes both obstacles to attract resources (funding liquidity risk) and asset liquidation risk. The first assumes that the bank will not have an opportunity to attract resources from the market at a cost that is available to other market participants. In the second case, the bank will not be able to sell its assets without significant losses.</p> <p>Point 95 of Regulation 4 specifies that the bank's policies concerning liquidity management should at least include the sources to meet the bank's liquidity requirements, desirable or targeted structure and maturity limits of the bank's liabilities, limits of concentrations of funding sources, limitations of attracting borrowings from related parties, the criteria for selecting alternative sources of liquid funds in case when the primary sources are unavailable,</p>

	<p>permissible limits of maturity gap of the bank's assets and liabilities, approaches of diversification of funds by individual currencies, and a requirement to perform current analysis of sensitivity of collateral prices, etc.</p> <p>The liquidity risk management process should be reviewed and revised at a frequency defined by the Board to ensure the promptness and validity of the process. The banks should use the results of stress testing during development long-term business plans, as well as during liquidity planning.</p>
EC6	<p>The supervisor determines that banks have robust liquidity contingency funding plans to handle liquidity problems. The supervisor determines that the banks' contingency funding plan is formally articulated, adequately documented and sets out the bank's strategy for addressing liquidity shortfalls in a range of stress environments without placing reliance on lender of last resort support. The supervisor also determines that the bank's contingency funding plan establishes clear lines of responsibility, includes clear communication plans (including communication with the supervisor) and is regularly tested and updated to ensure it is operationally robust. The supervisor assesses whether, in the light of the bank's risk profile and systemic importance, the bank's contingency funding plan is feasible and requires the bank to address any deficiencies.</p>
Description and findings re EC6	<p>Point 95(21) of Regulation 4 defines that the bank's internal control system, concerning liquidity management, should at least include the requirement for availability and regular revision of an action plan in liquidity crisis (unexpected) situations, including the requirement for availability of funding in emergency situations. In addition, the Liquidity Risk Management Manual includes specific recommendations with regard to the development of liquidity contingency plans for all banks. Liquidity buffers are required for worst case scenarios that are idiosyncratic to the institution, linked to market conditions and a combination of the two. Banks are required to plan contingencies assuming a one-month and one-week survival period.</p> <p>According to point 80 of Regulation 4, based on the results of performed stress tests, the bank should develop its action plan in stress (emergency) situations, which should at least include the description of the bank's key areas, systems, division in emergency situations. Stress action plans should be tested on an annual basis to ascertain their effectiveness and should be updated if necessary.</p> <p>Banks are required to submit their contingency plans to the CBA. The supervisor assesses whether the bank's contingency funding plan is formally articulated and adequately documented. If any deficiencies are identified, the supervisor has the power to require the bank to address them.</p>
EC7	<p>The supervisor requires banks to include a variety of short-term and protracted bank-specific and market-wide liquidity stress scenarios (individually and in combination), using conservative and regularly reviewed assumptions, into their stress testing programs for risk management purposes. The supervisor determines that the results of the stress tests are used by the bank to adjust its liquidity risk management strategies, policies and positions and to develop effective contingency funding plans.</p>
Description and findings re EC7	<p>According to Chapter 6 of Regulation 4, banks are required to perform stress testing for liquidity risk at least on a monthly basis. Stress testing should be performed based on the banks projected base case scenario, and further subject to market shocks reflecting at least two levels (moderate and severe) of extreme but probable conditions. Stress tests, can be a simple sensitivity analysis, depending on the changes of a specific risk factor, as well as more complex ones, which take into consideration different risk factors, including the results of systemic interconnection.</p> <p>The regulation states that stress testing should form a part of the bank's risk management process by promoting improvements in the quality of risk management and providing an</p>

	<p>additional tool. The results of stress-tests should have practical importance: they should affect the decision making of the bank's managers, including the strategic decisions of the bank's Board and senior management. In particular, stress tests should be used when defining the bank's risk appetite or the limits on liquidity risk. The results should be also used during liquidity planning.</p> <p>On-site reviews are used to assess the incorporation of stress testing into risk management processes. Off-site, there is an ongoing process to review submitted regulatory reports and stress tests, as well as the contingency liquidity plan that accompanies the stress tests.</p>
EC8	<p>The supervisor identifies those banks carrying out significant foreign currency liquidity transformation. Where a bank's foreign currency business is significant, or the bank has significant exposure in a given currency, the supervisor requires the bank to undertake separate analysis of its strategy and monitor its liquidity needs separately for each such significant currency. This includes the use of stress testing to determine the appropriateness of mismatches in that currency and, where appropriate, the setting and regular review of limits on the size of its cash flow mismatches for foreign currencies in aggregate and for each significant currency individually. In such cases, the supervisor also monitors the bank's liquidity needs in each significant currency and evaluates the bank's ability to transfer liquidity from one currency to another across jurisdictions and legal entities.</p>
Description and findings re EC8	<p>Armenian banks attract dollar denominated deposits and extend dollar denominated loans. Paragraph 95(18) of Regulation 4 requires banks to develop approaches of diversification of attracted funds and distributed funds by individual currency. The prudential returns provide regular reports on banks' FX positions and FX transactions.</p> <p>In addition, the CBA has set prudential ratios to limit banks' FX risk. The ratios are set for individual currencies as well as aggregate positions. In addition, the CBA has adopted liquidity ratios based on individual currencies. According to those ratios, banks are required to meet the liquidity ratios not only on the aggregate basis, but also separately for the Group I foreign currencies, and each Group II foreign currency, which is material for the given bank (the currency should be considered as material, if the liabilities of the bank, denominated in that particular currency, will exceed 5 percent of the bank's total liabilities).</p> <p>During its off-site analysis, the supervisor also monitors the bank's liquidity needs in each significant currency.</p>
Additional criteria	
AC1	<p>The supervisor determines that banks' levels of encumbered balance-sheet assets are managed within acceptable limits to mitigate the risks posed by excessive levels of encumbrance in terms of the impact on the banks' cost of funding and the implications for the sustainability of their long-term liquidity position. The supervisor requires banks to commit to adequate disclosure and to set appropriate limits to mitigate identified risks.</p>
Description and findings re AC1	<p>The CBA has adopted total and current liquidity ratios, which are defined as "highly liquid assets/total assets" and "highly liquid assets/demand liabilities", respectively. Thus, the CBA requires the bank to hold a portion of highly liquid assets which are not encumbered, mitigating the risk, posed by excessive levels of encumbrance.</p>
Assessment of Principle 24	Compliant
Comments	<p>Although the CBA's approach to supervising liquidity risk is rated compliant with requirements of the Core Principles, it is recommended that the CBA adopt the LCR and NSFR ratios as soon as practical. The obstacles to adoption of the LCR concern the lack of sufficient HQLA in foreign currency. The issue may be addressed by changing the composition of the FX reserve</p>

	requirements, i.e., allowing the fulfillment of FX reserve requirement with FX rather than Armenian dram.
Principle 25	Operational risk. The supervisor determines that banks have an adequate operational risk management framework that takes into account their risk appetite, risk profile and market and macroeconomic conditions. This includes prudent policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk⁵⁸ on a timely basis.
Essential criteria	
EC1	Law, regulations or the supervisor require banks to have appropriate operational risk management strategies, policies and processes to identify, assess, evaluate, monitor, report and control or mitigate operational risk. The supervisor determines that the bank's strategy, policies and processes are consistent with the bank's risk profile, systemic importance, risk appetite and capital strength, take into account market and macroeconomic conditions, and address all major aspects of operational risk prevalent in the businesses of the bank on a bank-wide basis (including periods when operational risk could increase).
Description and findings re EC1	Chapter 4 of Regulation 4 requires that banks should ensure the existence of an effective system of risk management (including operational risk), approved by the Board, which should be consistent with the risk nature of the bank's activity, volume and complexity of business processes. The risk management system should at least include the risk management strategy, risk appetite of the bank, operational risk management policies, which should at least define acceptable limits of operational risk, implementation of mechanisms of risk reduction, processes and tools of identification, assessment, mitigation, monitoring and reporting of operational risk, duties and authorities of the bank's particular business unit and employees, involved in the risk management process. In addition, the CBA has also issued a Guideline to banks on Operational Risk Management, which sources heavily from the Basel Committee guidance on operational risk. During onsite examinations the supervisor ensures the policies are approved by the Board and effectively implemented by senior management. In 2017, the Operational Risk Team within the FSD conducted a thematic review of operational risk management in four large banks to assess the quality of their operational risk management. One of the objectives was to assess the quality of the operational risk databases.
EC2	The supervisor requires banks' strategies, policies and processes for the management of operational risk (including the banks' risk appetite for operational risk) to be approved and regularly reviewed by the banks' Boards. The supervisor also requires that the Board oversees management in ensuring that these policies and processes are implemented effectively.
Description and findings re EC2	Regulation 4 requires bank's strategies, policies and processes for the management of operational risk to be approved and periodically reviewed by the Board. The supervisory requirements also stipulate that the Board must oversee the senior management to ensure that these policies and procedures are effectively implemented. The CBA on-site and off-site examiners assess whether these requirements are implemented in banks. One of the five specialized risk teams established in 2016 is dedicated to Operational Risk. The main objective was to deepen knowledge and expertise of supervisors in this risk area, integrate all the specialized knowledge across banks about this risk, and have a system-wide view of operational risk. The team is currently developing risk assessment/analysis tools (questionnaires, criteria for measuring risks, etc.) and works in close cooperation with the supervisors on-site. A thematic

⁵⁸ The Committee has defined operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. The definition includes legal risk but excludes strategic and reputational risk.

	review to assess the quality of the “raw data” report sent to the CBA has been scheduled in nine banks in 2018. Operational risk inspections are planned in three banks.
EC3	The supervisor determines that the approved strategy and significant policies and processes for the management of operational risk are implemented effectively by management and fully integrated into the bank’s overall risk management process.
Description and findings re EC3	<p>Regulation 4 requires that banks ensure the existence of effective system of risk management, which includes risk management strategy, risk appetite of the bank and operational risk management policy, approved by the Board. During their on-site inspections and thematic reviews, the supervisors assess whether the adopted policies and processes are implemented effectively by senior management and are fully integrated into the bank’s risk management process.</p> <p>In 2018, the operational risk team prepared and sent questionnaires to all banks to conduct a self-assessment for operational risk management. The results of these self-assessments will be used both in assessing the quality of operational risk management in individual banks and deciding on making more detailed guidance/requirements for operational risk management in banks.</p>
EC4	The supervisor reviews the quality and comprehensiveness of the bank’s disaster recovery and business continuity plans to assess their feasibility in scenarios of severe business disruption which might plausibly affect the bank. In so doing, the supervisor determines that the bank is able to operate as a going concern and minimize losses, including those that may arise from disturbances to payment and settlement systems, in the event of server business disruption.
Description and findings re EC4	<p>Under Chapter 10 of Regulation 4, banks should identify, assess, manage and decrease risks, which endanger the bank’s business continuity. Bank’s business continuity management systems should include the bank’s business continuity management policy, goals and strategy of recovery of business processes, plan of regular testing and updating of the action plan ensuring business continuity. The bank’s business continuity management system should be adapted to the nature, size and complexity of the bank’s activities. During the assessment of risks, banks are expected to identify risks that can result in failure of key business processes. For those risks, a mitigation strategy should be developed. The bank’s action plan should be tested at least once a year, or more frequently in cases of significant changes.</p> <p>Under Regulation 1, banks are required to submit their internal procedures, including the business continuity management policy, to the Central Bank. The supervisors, supported by the Operational Risk Team created in 2016, assess the quality and comprehensiveness of the plans as part of their onsite and offsite supervision.</p>
EC5	The supervisor determines that banks have established appropriate IT policies and processes to identify assess, monitor and manage technology risks. The supervisor also determines that banks have appropriate and sound IT infrastructure to meet their current and projected business requirements (under normal circumstances and in periods of stress), which ensures data and system integrity, security and availability and supports integrated and comprehensive risk management.
Description and findings re EC5	According to point 139 of Regulation 4, banks should ensure the security and continuity of electronic systems of information storage and processing. The regulation on the “Procedure on definition of minimum requirement for ensuring information security” (Resolution 173-N as of 09.07.2013) requires that the bank should have an information security policy, approved by the top management of the bank. The policy should be updated at least once every three years, and more frequently in cases where there are significant management changes. The bank should develop regulations, procedures and/or rules, which will regulate any process related to ensuring information security. During onsite inspections, the supervisors assess whether the banks have appropriate and sound IT infrastructure to meet their business requirements.
EC6	The supervisor determines that banks have appropriate and effective information systems to:

	<ul style="list-style-type: none"> (a) monitor operational risk; (b) compile and analyze operational risk data; and (c) facilitate appropriate reporting mechanisms at the banks' Boards, senior management and business line levels that support proactive management of operational risk.
Description and findings re EC6	<p>According to point 134 of Regulation 4, the internal control system of banks should provide for valid and effective information and reporting systems. Banks should adopt internal policies, defining the forms of reports, submitted to the bank's Board and executive body, as well as the procedure and frequency of submission, etc. This should include reports about operational risk and should allow the bank's Board and senior management to (i) assess the current situation, trend of changes, their impact on the bank's activity and level of riskiness, (ii) react timely and adequately and undertake appropriate measures, and (iii) increase the effectiveness of decision-making processes of the bank's Board and senior management.</p> <p>Regulation 3 on Banks reporting requires banks to submit a quarterly report on "Material changes and negative developments at a bank". This report includes, inter alia, information on material losses (i.e., equal to or more than 5% of a bank's regulatory capital) borne or likely to be borne by the bank stemming from credit, market, operational, liquidity, reputation or other risks. Banks are also required to submit a report on frauds or attempts of fraud on a quarterly basis and when such frauds occur. These two reports are used in the supervision process on an on-going basis to understand their causes and further planned steps by banks to mitigate those risks. Assessors were provided with samples of examinations.</p>
EC7	The supervisor requires that banks have appropriate reporting mechanisms to keep the supervisor apprised of developments affecting operational risk at banks in their jurisdictions.
Description and findings re EC7	<p>According to Regulation 3 (form 28), banks are required to submit reports to the CBA on fraud and attempts of fraud. In addition, according to form 35 of Regulation 3, the bank is required to inform the CBA if it has incurred or expects to incur material losses due to operational risk and other risks. The information, submitted by the bank, should include (i) the causes of losses, their description and impact, (ii) the measures to be taken by the bank to make the appropriate corrections, (iii) other necessary information in bank's opinion, and (iv) contact information of the person in charge. The CBA also gets information on developments as part of onsite examinations.</p>
EC8	<p>The supervisor determines that banks have established appropriate policies and processes to assess, manage and monitor outsourced activities. The outsourcing risk management program covers:</p> <ul style="list-style-type: none"> (a) conducting appropriate due diligence for selecting potential service providers; (b) structuring the outsourcing arrangement; (c) managing and monitoring the risks associated with the outsourcing arrangement; (d) ensuring an effective control environment; and (e) establishing viable contingency planning. <p>Outsourcing policies and processes require the bank to have comprehensive contracts and/or service level agreements with a clear allocation of responsibilities between the outsourcing provider and the bank.</p>
Description and findings re EC8	<p>The December 2017 amendments to the LBB (article 34) specify that banks may outsource their activities to third party providers, for which they need to get the Central Bank's prior consent. A draft regulation is at final stage of review by the Ministry of Justice before adoption.</p> <p>Once the regulation is adopted, any outsourcing agreement, which has been signed without the prior consent of the Central Bank, shall be void. The bank shall remain responsible for the functions/activities outsourced to third parties. The CBA has been granted the right to conduct examinations at the service provider's premises on the functions/activities outsourced. Article 34 also specifies that upon the CBA request, the bank is obliged to amend/terminate the outsourcing contract signed with the service provider. In addition, some aspects of outsourcing</p>

	<p>are described by Regulation on the “Procedure on definition of minimum requirement for ensuring information security” (Resolution 173-N as of 09.07.2013).</p> <p>On-site examiners include outsourcing practices and impact analysis in the scope of their examinations as observed by the assessors.</p>
Additional criteria	
AC1	The supervisor regularly identifies any common points of exposure to operational risk or potential vulnerability (e.g., outsourcing of key operations by many banks to a common service provider or disruption to outsourcing providers of payment and settlement activities).
Description and findings re AC1	During their day-to-day supervision, the supervisors regularly identify the common points of exposure to operational risk or potential vulnerability. For example, CBA is closely monitoring the conditions of IT services outsourcing by most of the banks to only two main companies in Armenia.
Assessment of Principle 25	Largely compliant
Comments	<p>Reinforced with the creation of a Risk team dedicated to Operational risk, the recent activities of FSD in this domain indicate extensive focus on operational risk and risk management in the last two years (survey of top 10 risks in the banks in 2017, thematic examination on data bases, on-site examination in 9 banks in 2018). Greater prudential focus is the main outcome compared to the previous procedures focused on topics such as physical security and branch inspections, which are better addressed by the banks’ own internal audit functions. This allows examiners to dedicate resources to the risks more likely to threaten the soundness of the bank.</p> <p>FSD has a clear view of the operational risks in the system and in each individual bank, though this knowledge must still be confirmed through the upcoming on-site focused examinations scheduled under the RBS framework. The team is currently developing risk assessment/analysis tools (questionnaires, criteria for measuring risks, etc.) and works to finalize the procedures in close cooperation with the supervisors. A thematic review has been scheduled in nine banks in 2018.</p>
Principle 26	Internal control and audit. The supervisor determines that banks have adequate internal control frameworks to establish and maintain a properly controlled operating environment for the conduct of their business taking into account their risk profile. These include clear arrangements for delegating authority and responsibility; separation of the functions that involve committing the bank, paying away its funds, and accounting for its assets and liabilities; reconciliation of these processes; safeguarding the bank’s assets; and appropriate independent⁵⁹ internal audit and compliance functions to test adherence to these controls as well as applicable laws and regulations.
Essential criteria	
EC1	Laws, regulations or the supervisor require banks to have internal control frameworks that are adequate to establish a properly controlled operating environment for the conduct of their business, taking into account their risk profile. These controls are the responsibility of the bank’s Board and/or senior management and deal with organizational structure, accounting policies and processes, checks and balances, and the safeguarding of assets and investments (including measures for the prevention and early detection and reporting of misuse such as

⁵⁹ In assessing independence, supervisors give due regard to the control systems designed to avoid conflicts of interest in the performance measurement of staff in the compliance, control and internal audit functions. For example, the remuneration of such staff should be determined independently of the business lines that they oversee.

	<p>fraud, embezzlement, unauthorized trading and computer intrusion). More specifically, these controls address:</p> <p>(a) organizational structure: definitions of duties and responsibilities, including clear delegation of authority (e.g., clear loan approval limits), decision-making policies and processes, separation of critical functions (e.g., business origination, payments, reconciliation, risk management, accounting, audit and compliance);</p> <p>(b) accounting policies and processes: reconciliation of accounts, control lists, information for management;</p> <p>(c) checks and balances (or “four eyes principle”): segregation of duties, cross-checking, dual control of assets, double signatures; and</p> <p>(d) safeguarding assets and investments: including physical control and computer access.</p>
Description and findings re EC1	<p>Point 13 of Regulation 4 requires that the bank’s internal control system should ensure implementation of secure and normal banking activity, taking into consideration the profile of the bank’s activity, its existing and possible risks, requirements of laws and other legal acts, business processes and the bank’s activities. The internal control system should describe the bank’s organizational structure and properly segregate duties and authorities of the bank’s divisions and employees. Potential areas of conflicts of interest should be disclosed and controlled. The bank’s internal control system should describe the ways to provide necessary information for sustainable and effective implementation of the business process, as well as information flows within the bank (divisions, managers, employees, etc.). Point 19 of Regulation 4 specifies that checks and balances must be in place to avoid one person or a related interest having control over a transaction from initiation to its final disposition.</p> <p>The CBA determines the adequacy of the internal control regime through its inspection process, both on and off-site.</p>
EC2	<p>The supervisor determines that there is an appropriate balance in the skills and resources of the back office, control functions and operational management relative to the business origination units. The supervisor also determines that the staff of the back office and control functions have sufficient expertise and authority within the organization (and, where appropriate, in the case of control functions, sufficient access to the bank’s Board) to be an effective check and balance to the business origination units.</p>
Description and findings re EC2	<p>In addition to the regulatory requirements outlined in EC 1, the RBS supervision process includes procedures for “Assessment of Governance Quality”, which covers assessments of operational management, risk management functions, compliance functions, senior managers and the Board and their committees. For each of these management layers, examiners assess whether their objectives and authorities are clear with regard to their mandates for controls, whether the organizational structure is conducive to effective performance of their mandates, the existence of the necessary quality and quantity of resources, whether performance of the function is consistent with the scope and complexity of risks being managed, the adequacy of reporting of findings to the Board and senior management, quality control over the operations, and adequacy of documentation.</p>
EC3	<p>The supervisor determines that banks have an adequately staffed, permanent and independent compliance function⁶⁰ that assists senior management in managing effectively the compliance risks faced by the bank. The supervisor determines that staff within the compliance function is suitably trained, have relevant experience and have sufficient authority within the bank to</p>

⁶⁰ The term “compliance function” does not necessarily denote an organizational unit. Compliance staff may reside in operating business units or local subsidiaries and report up to operating business line management or local management, provided such staff also have a reporting line through to the head of compliance who should be independent from business lines.

	perform their role effectively. The supervisor determines that the bank's Board exercises oversight of the management of the compliance function.
Description and findings re EC3	<p>Article 21.14 of LBB, Chapters 13 and 15 of Regulation 4 require that as an element of the internal control system, banks should have a compliance function that supports the bank in complying with banking laws and regulations and encourages a corporate culture of compliance. The person responsible for the compliance function should identify and assess the risks related to general legal and supervisory requirements and ensure their compliance with the bank's activity. The bank should ensure enough authority, independence and resources for the compliance function to effectively meet its responsibilities. The head of compliance should have the opportunity to express independent and objective opinions about the problems under his/her responsibility, as well as directly talk to and regularly meet with (without the presence of the executive body) the Chairman of the Board. Effectiveness of implementation of the compliance function should be regularly assessed by the Board, according to the criteria defined by the Board. To perform the assessment, the Board should define the content, format, and frequency of reports submitted to the Board. The reports should give opportunity to the Board to assess the quality of work done by the persons responsible for the compliance function.</p> <p>As discussed more fully under EC 2, the RBS manual details specific criteria for assessing control functions, including compliance and risk management functions.</p>
EC4	<p>The supervisor determines that banks have an independent, permanent and effective internal audit function⁶¹ charged with:</p> <p>(a) assessing whether existing policies, processes and internal controls (including risk management, compliance and corporate governance processes) are effective, appropriate and remain sufficient for the bank's business; and</p> <p>(b) ensuring that policies and processes are complied with.</p>
Description and findings re EC4	<p>Chapter 16 of Regulation 4 requires that banks must have an effective internal audit function that provides for independent and impartial assurance that policies, processes and internal controls are effective and appropriate. Banks should ensure that the audit head and members of the internal audit division adhere to the following principles: independence, integrity, objectivity, confidentiality and competency.</p> <p>Internal audit work should include, inter alia, monitoring and assessment of: (i) the adequacy and effectiveness of the bank's policy, processes, their documentation and implementation of control mechanisms, from the point of view of the bank, group (if the bank is a member of a group), business unit, business area, (ii) the effectiveness of risk management and compliance functions, (iii) compliance of activity of the bank and its managers with requirements of laws, normative and other legal acts, including the bank's procedures (regulations, procedures, orders, guidelines, etc.), (iv) compliance of the bank's employees and organizational units with the bank's internal policies and procedures, (v) the effectiveness of the bank's internal control system and its adequacy to the bank's risks, (vi) internal information and reporting systems, (vii) effectiveness of the functions outsourced by the bank.</p> <p>Internal audit should perform follow-up activities regarding implementation of corrective measures that were recommended as a result of internal and external audits or were recommended as a result of examinations performed by the Central Bank.</p> <p>The CBA actively reviews work performed by the internal audit departments as part of its scoping and review of all material operations and conducts reviews of the audit departments regularly.</p>
EC5	The supervisor determines that the internal audit function:

⁶¹ The term "internal audit function" does not necessarily denote an organizational unit. Some countries allow small banks to implement a system of independent reviews, e.g., conducted by external experts, of key internal controls as an alternative.

	<ul style="list-style-type: none"> (a) has sufficient resources, and staff that are suitably trained and have relevant experience to understand and evaluate the business they are auditing; (b) has appropriate independence with reporting lines to the bank's Board or to an audit committee of the Board, and has status within the bank to ensure that senior management reacts to and acts upon its recommendations; (c) is kept informed in a timely manner of any material changes made to the bank's risk management strategy, policies or processes; (d) has full access to and communication with any member of staff as well as full access to records, files or data of the bank and its affiliates, whenever relevant to the performance of its duties; (e) employs a methodology that identifies the material risks run by the bank; (f) prepares an audit plan, which is reviewed regularly, based on its own risk assessment and allocates its resources accordingly; and (g) has the authority to assess any outsourced functions.
Description and findings re EC5	<p>Chapters 13 and 16 of Regulation 4 require that the bank should ensure enough authority, independence and resources for the internal audit function to effectively meet the responsibilities defined for the function. The head and members of internal audit unit are appointed by the Board and should have the opportunity to directly talk to and regularly meet with (without the presence of the executive body) the Chairman of the Board. The chief internal auditor and members of internal audit are treated as bank managers by article 22 of LBB and accordingly, professional requirements and CBA qualification tests are applied to them. According to point 180 of Regulation 4, the employees of internal audit should be given enough authorities to achieve their responsibilities. They should be authorized to receive all necessary documents (information), and enter the examined division and other areas, where documents (archives), cash, other values (bunker), computer processing of information are kept.</p> <p>Each year the Board should approve the annual work plan of the internal audit division. When planning the work of internal audit, at least the following should be taken into consideration: (i) the bank's risk management system, including risk management strategy, risk appetite, risk management policies for specific risks, (ii) results of assessment of riskiness of the bank's operations and processes, (iii) results of similar audit examinations in the past. Internal auditors should prioritize allocation resources for completing their objectives taking into consideration the nature and complexity of the functions under audit and available resources.</p> <p>In addition, point 170(18) of Regulation 4 specifies, that internal audit's work should at least include the assessment of effectiveness of the functions outsourced by the bank.</p> <p>During on-site examinations, the supervisor ensures that internal audit has sufficient resources, skills and expertise to evaluate the business they are auditing, has appropriate independence, full access to all necessary information, and direct reporting to the board. The RBS manual details specific criteria for assessing control functions, including compliance and risk management functions.</p>
Assessment of Principle 26	Compliant
Comments	Policies and procedures for evaluating internal control, compliance and internal audit functions appear adequate.
Principle 27	Financial reporting and external audit. The supervisor determines that banks and banking groups maintain adequate and reliable records, prepare financial statements in accordance with accounting policies and practices that are widely accepted internationally and annually publish information that fairly reflects their financial condition and performance and bears an independent external auditor's opinion. The

supervisor also determines that banks and parent companies of banking groups have adequate governance and oversight of the external audit function.	
Essential criteria	
EC1	The supervisor ⁶² holds the bank's Board and management responsible for ensuring that financial statements are prepared in accordance with accounting policies and practices that are widely accepted internationally and that these are supported by recordkeeping systems in order to produce adequate and reliable data.
Description and findings re EC1	Articles 11 and 12 of the Law on Accounting provides that the supervisor has the authority to hold management responsible for accurate and reliable record keeping and for publishing (quarterly and annual) financial information. According to the Law, the banks are required to prepare and publish their financial statements in accordance with International Financial Reporting Standards (IFRS).
EC2	The supervisor holds the bank's Board and management responsible for ensuring that the financial statements issued annually to the public bear an independent external auditor's opinion as a result of an audit conducted in accordance with internationally accepted auditing practices and standards.
Description and findings re EC2	Articles 58 and 59 of the LBB states that the annual reports must be verified by an external auditor and that the reports must be published. Resolution 39-N, on Election of External Auditor of Banks specifies that for banks, a firm must have a minimum of five years' experience in auditing banks or insurance companies, or must be an internationally recognized audit firm; that the audit manager must have three years' experience auditing no less than five firms; and that internationally recognized certifications are held (CPA, ACPA, CISA). The CBA holds the bank's Board and management responsible for compliance with these requirements.
EC3	The supervisor determines that banks use valuation practices consistent with accounting standards widely accepted internationally. The supervisor also determines that the framework, structure and processes for fair value estimation are subject to independent verification and validation, and that banks document any significant differences between the valuations used for financial reporting purposes and for regulatory purposes.
Description and findings re EC3	According to the Law on Accounting, banks are required to comply with IFRSs which sets rules and methods for the proper valuation of assets and liabilities. These methods are reviewed for IFRS compliance by external auditors. If any issues are identified, external auditors are required to disclose them to the CBA. As a practical matter, external auditors conveyed to the assessors that fair value accounting in Armenian banks for loans, investments, and fixed assets is not complex and based on widely available information.
EC4	Laws or regulations set, or the supervisor has the power to establish the scope of external audits of banks and the standards to be followed in performing such audits. These require the use of a risk and materiality-based approach in planning and performing the external audit.
Description and findings re EC4	The Law on Accounting provides that banks must prepare their accounts in accordance with IFRS and have them audited in accordance with internationally accepted auditing practices and standards. In addition, according to article 58 of LBB the Central Bank can force the bank to hold an external audit within 4 months and to publish the results. As a practical matter, only foreign based firms (EY, PWC, KPMG, Deloitte and Grant Thornton) are permitted to conduct bank audits. See EC 2 for a description of Regulation 39 N.
EC5	Supervisory guidelines or local auditing standards determine that audits cover areas such as the loan portfolio, loan loss provisions, non-performing assets, asset valuation, trading and other securities activities, derivatives, asset securitizations, consolidation of and other

⁶² In this Essential Criterion, the supervisor is not necessarily limited to the banking supervisor. The responsibility for ensuring that financial statements are prepared in accordance with accounting policies and practices may also be vested with securities and market supervisors.

	involvement with off-balance sheet vehicles and the adequacy of internal controls over financial reporting.
Description and findings re EC5	The Ministry of Finance is responsible for setting auditing standards in Armenia. This consists of adopting best international practice and applying it to the audit profession in Armenia. Also, Article 58 of the LBB stipulates that the external auditor immediately inform the CBA about any deficiencies in the internal controls of banks. As was mentioned in EC 2, annual reports of banks must be verified by an external auditor. The scope of the audit includes loan portfolio, loan loss provisions, non-performing assets, asset valuations, trading and other securities activities, derivatives and other directions, mentioned in EC 5.
EC6	The supervisor has the power to reject and rescind the appointment of an external auditor who is deemed to have inadequate expertise or independence, or is not subject to or does not adhere to established professional standards.
Description and findings re EC6	Under 58 (3) of the LBB, the CBA may oblige a bank to replace an external auditor.
EC7	The supervisor determines that banks rotate their external auditors (either the firm or individuals within the firm) from time to time.
Description and findings re EC7	According to the "Procedure of election of independent audit company by banks operating on the territory of the Republic of Armenia" (Resolution No 39-N as of 01.03.2011), the same responsible auditor cannot conduct the audit of the financial and economic activity of the same bank, if he/she has continually conducted the audit of financial and economic activity of that bank during the three financial years preceding the given financial year.
EC8	The supervisor meets periodically with external audit firms to discuss issues of common interest relating to bank operations.
Description and findings re EC8	Chapter 2(4)(4) of the "Procedure of election of independent audit company by banks operating on the territory of the Republic of Armenia" (Resolution No 39-N as of 01.03.2011), provides that the banks should elect the external audit company, which agrees to take part in trilateral meetings between the bank, audit company, and the CBA for discussion of the results of the external audit. In practice, such meetings regularly take place.
EC9	The supervisor requires the external auditor, directly or through the bank, to report to the supervisor matters of material significance, for example failure to comply with the licensing criteria or breaches of banking or other laws, significant deficiencies and control weaknesses in the bank's financial reporting process or other matters that they believe are likely to be of material significance to the functions of the supervisor. Laws or regulations provide that auditors who make any such reports in good faith cannot be held liable for breach of a duty of confidentiality.
Description and findings re EC9	Article 58(2) of the LBB provides that the external auditor shall promptly notify the CBA of any significant deterioration of a bank's performance or deficiencies in its internal structure (including the system of internal control). The Law on Bank Secrecy (Article 5) provides that Auditors who make any such reports in good faith cannot be held liable for a breach of duty of confidentiality.
Additional criteria	
AC1	The supervisor has the power to access external auditors' working papers, where necessary.
Description and findings re AC1	Article 58(5) of LBB requires the external auditor to provide the CBA with all necessary documents regarding the audit of a bank irrespective whether they represent any commercial, bank or other secrets. The external auditor is subject to sanctions if he defaults on this obligation.
Assessment of Principle 27	Compliant

Comments	Banks are required to be audited annually by a firm applying international auditing standards. In practice, only internationally recognized big firms (EY, PWC, KPMG, Deloitte, Grant Thornton Armenia) are permitted to audit banks. All public reporting is under IFRS.
Principle 28	Disclosure and transparency. The supervisor determines that banks and banking groups regularly publish information on a consolidated and, where appropriate, solo basis that is easily accessible and fairly reflects their financial condition, performance, risk exposures, risk management strategies and corporate governance policies and processes.
Essential criteria	
EC1	Laws, regulations or the supervisor require periodic public disclosures ⁶³ of information by banks on a consolidated and, where appropriate, solo basis that adequately reflect the bank's true financial condition and performance, and adhere to standards promoting comparability, relevance, reliability and timeliness of the information disclosed.
Description and findings re EC1	Article 59 of the LBB defines that within four months upon completion of the financial year the banks should publish the auditor's opinion and the annual financial report in the press. Also, the banks should publish their quarterly financial statements before the 15 th day of the month following each quarter. According to the Law on Accounting, the banks must prepare and publish their financial statements in accordance with IFRS, which will promote comparability, relevance, reliability and timeliness of the information disclosed.
EC2	The supervisor determines that the required disclosures include both qualitative and quantitative information on a bank's financial performance, financial position, risk management strategies and practices, risk exposures, aggregate exposures to related parties, transactions with related parties, accounting policies, and basic business, management, governance and remuneration. The scope and content of information provided, and the level of disaggregation and detail is commensurate with the risk profile and systemic importance of the bank.
Description and findings re EC2	The "Instructions for completing the financial reporting forms, published by the banks" (Resolution No 205-N as of 10.07.2007) specifies the rules and standards for banks, concerning the disclosure in their financial statements. They include both qualitative and quantitative information.
EC3	Laws, regulations or the supervisor require banks to disclose all material entities in the group structure.
Description and findings re EC3	Article 39.19(1) of LCB defines that the responsible person of the financial group is obliged to disclose on its official web page the statements and information about the financial group, specified by the Board of the Central Bank. According to Regulation 8/03, the responsible entity discloses information on the structure of financial group, direct and indirect participants, ultimate beneficial owners, etc.
EC4	The supervisor or another government agency effectively reviews and enforces compliance with disclosure standards.
Description and findings re EC4	The CBA verifies the reliability of banks' disclosure standards through the on-site and off-site supervision process as well as through the annual audit process. Article 60 of the LBB allows the CBA to apply sanctions for infringements of legislation including failures to comply with disclosure requirements.
EC5	The supervisor or other relevant bodies regularly publishes information on the banking system in aggregate to facilitate public understanding of the banking system and the exercise of market discipline. Such information includes aggregate data on balance sheet indicators and statistical parameters that reflect the principal aspects of banks' operations (balance sheet structure, capital ratios, income earning capacity, and risk profiles).

⁶³ For the purposes of this Essential Criterion, the disclosure requirement may be found in applicable accounting, stock exchange listing, or other similar rules, instead of or in addition to directives issued by the supervisor.

Description and findings re EC5	The CBA regularly publishes such information in a number of ways: in its Annual report, in quarterly bulletins and in semi-annual reports, prepared by the FSSDD.
Additional criteria	
AC1	The disclosure requirements imposed promote disclosure of information that will help in understanding a bank's risk exposures during a financial reporting period, for example on average exposures or turnover during the reporting period.
Description and findings re AC1	According to the "Instructions for completing the financial reporting forms, published by the banks" (Resolution No 205-N as of 10.07.2007), the banks should disclose the following statements: (i) statement of financial position, (ii) income statement, (iii) cash flow statement, (iv) statement of changes in equity, (v) notes to the comprehensive financial reports, comprising the accounting policy. The statements should be prepared and disclosed in accordance with IFRS. The disclosed information includes the ones, mentioned in AC 1.
Assessment of Principle 28	Compliant
Comments	All banks are audited annually under IFRS and make required disclosures.
Principle 29	Abuse of financial services. The supervisor determines that banks have adequate policies and processes, including strict customer due diligence (CDD) rules to promote high ethical and professional standards in the financial sector and prevent the bank from being used, intentionally or unintentionally, for criminal activities.⁶⁴
Essential criteria	
EC1	Laws or regulations establish the duties, responsibilities and powers of the supervisor related to the supervision of banks' internal controls and enforcement of the relevant laws and regulations regarding criminal activities.
Description and findings re EC1	<p>According to Article 39.1 of LCB, the CBA acts as the supervisory body for financial institutions operating in the territory of Armenia. Based on Article 29 of the Law on Combating Money Laundering and Terrorist Financing (AML/CFT Law) "supervision over banks on their compliance with the requirements of the law and the legal statutes adopted on the basis thereof shall be exercised by relevant supervisory authorities".</p> <p>The Financial Monitoring Center (FMC), which serves as the Armenian FIU (Article 10.2 of the AML/CFT Law), is a structural unit established within the CBA acting as a national center for receiving and analyzing suspicious transaction reports (STRs) and other information relevant to ML/TF and associated predicate offences, and for disseminating the results of that analysis. The FMC is the central agency for the receipt of disclosures filed by reporting entities, including: i) STRs and ii) TTRs (threshold transaction reports) filed according to certain types of transactions, including cash-related transactions, transactions involving real estate, transactions related to managing of client property, bank and securities accounts.</p> <p>The Financial Supervision Department (FSD) and the FMC cooperate based on the 2012 "Manual on Cooperation between the Financial Monitoring Center and the Financial Supervision Department of the Central Bank of the Republic of Armenia" (hereinafter referred as the "Manual"). The Manual highlights the following areas of cooperation: joint planning and</p>

⁶⁴ The Committee is aware that, in some jurisdictions, other authorities, such as a financial intelligence unit (FIU), rather than a banking supervisor, may have primary responsibility for assessing compliance with laws and regulations regarding criminal activities in banks, such as fraud, money laundering and the financing of terrorism. Thus, in the context of this Principle, "the supervisor" might refer to such other authorities, in particular in Essential Criteria 7, 8 and 10. In such jurisdictions, the banking supervisor cooperates with such authorities to achieve adherence with the criteria mentioned in this Principle.

	<p>implementation of supervision; maintaining and summarizing relevant statistics; exchanging information on ML/TF suspicious transactions and business relationships; exchanging and discussing the findings of the financial analysis based on relevant requests; providing mutual assistance in the development of AML/CFT regulations, guidelines and other methodological materials, ML/TF typologies; implementing joint programs for AML/CFT training, retraining and counseling. Though the FSD is in charge of conducting on-site inspections, the FMC staff participates in AML/CFT inspections of banks.</p>
EC2	<p>The supervisor determines that banks have adequate policies and processes that promote high ethical and professional standards and prevent the bank from being used, intentionally or unintentionally, for criminal activities. This includes the prevention and detection of criminal activity and reporting of such suspected activities to the appropriate authorities.</p>
Description and findings re EC2	<p>According to Article 4 of the AML/CFT Law, financial institutions should identify and assess their potential and existing risks, and should have policies, controls, and procedures enabling them to effectively manage and mitigate identified risks. They should regularly, but at least once a year, review their potential and existing risks.</p> <p>According to Article 23 of the AML/CFT Law, banks should have in place and apply internal procedures (policies, concept papers, rules, regulations, instructions or other means) aimed at the prevention of ML/TF, having regard to the size and nature of the reporting entity's activities, as well as the pertinent risks.</p> <p>As for the reporting of suspicious activities, Article 7 of the AML/CFT Law requires banks (as reporting entities) "to recognize a transaction or business relationship, including an attempted transaction or business relationship, as suspicious and file with the Authorized Body a report on suspicious transaction or business relationship as stipulated under Article 8 of the Law, if it is suspected or there are reasonable grounds to suspect that the property involved is the proceeds of a criminal activity or is related to terrorism, terrorist acts, terrorist organizations or individual terrorists, or to those who finance terrorism, or was used in or is intended to be used for terrorism, or by terrorist organizations or individual terrorists, or by those who finance terrorism." Based on Clause 7 of Part 1 of Article 3 of the AML/CFT Law, the Authorized Body is the CBA.</p> <p>Part 2 of Article 10 of the AML/CFT Law states that the Financial Monitoring Center (FMC) within the CBA shall exercise the powers referred to under Part 1 of the Article. According to Article 15 of the AML/CFT Law, it is prohibited to establish and run a shell bank in the Republic of Armenia.</p> <p>Under the recently introduced risk-based approach (see also CP8), each bank is assigned one of the four grades for its AML/CFT risk profile: high, higher than medium, medium, and low. The classification is based on the combined assessment of inherent risk and quality of risk management in AML/CFT area. For the purposes of inherent risk assessment, the following factors are assessed: banks' customers risk (<i>number of high-risk customers and geographic location of customers</i>), geographic risk (<i>geographic location of transactions</i>) and product risk. For this purpose, the FSD Compliance risk team has developed an AML/CFT inherent risk assessment off-site tool, with a reporting form to gather once a year respective information to assess the inherent risk. This assessment, including risk management, is based on previous findings during on-site inspections, internal report of banks' internal monitoring units and internal audit findings.</p> <p>There is no mandated cycle for AML/CFT inspections in banks, however inspections and intensity of supervision are deemed dependent on banks' AML/CFT risk profile and are reflected in the banks' annual supervisory plans. Since 2017, on-site focused inspections are planned in the banks that are assigned higher risk grade, and especially those which have deficiencies in their quality of risk management.</p>

EC3	In addition to reporting to the financial intelligence unit or other designated authorities, banks report to the banking supervisor suspicious activities and incidents of fraud when such activities/incidents are material to the safety, soundness or reputation of the bank. ⁶⁵
Description and findings re EC3	According to Regulation 3, banks should report to CBA on fraud (actual fraud events or attempts of fraud). Reports are reviewed during off-site supervision and on-site inspections. In addition, banks are required to report to the CBA about identified suspicious transactions.
EC4	If the supervisor becomes aware of any additional suspicious transactions, it informs the financial intelligence unit and, if applicable, other designated authorities of such transactions. In addition, the supervisor, directly or indirectly, shares information related to suspected or actual criminal activities with relevant authorities.
Description and findings re EC4	As for information sharing on suspicious transactions, according to Chapter 5 of the Manual on Cooperation between the FMC and the FSD, supervisors shall substantiate the need for taking certain actions with regard to transactions or business relationships relevant for ML/TF or, in case of detecting indicia of suspicious transactions or business relationships, provide to the FMC the information at its disposal. As for information sharing on criminal activities, based on Part 1 of Article 17 of the Law on Banking Secrecy, bank managers (including the CBA supervisors) are obliged to notify the Criminal Prosecution Authorities of any imminent crimes or crimes already committed that are known to them.
EC5	The supervisor determines that banks establish CDD policies and processes that are well documented and communicated to all relevant staff. The supervisor also determines that such policies and processes are integrated into the bank's overall risk management and that there are appropriate steps to identify, assess, monitor, manage and mitigate risks of money laundering and the financing of terrorism with respect to customers, countries and regions, as well as to products, services, transactions and delivery channels on an ongoing basis. The CDD management program, on a group-wide basis, has as its essential elements: (a) a customer acceptance policy that identifies business relationships that the bank will not accept based on identified risks; (b) a customer identification, verification and due diligence program on an ongoing basis; this encompasses verification of beneficial ownership, understanding the purpose and nature of the business relationship, and risk-based reviews to ensure that records are updated and relevant; (c) policies and processes to monitor and recognize unusual or potentially suspicious transactions; (d) enhanced due diligence on high-risk accounts (e.g., escalation to the bank's senior management level of decisions on entering into business relationships with these accounts or maintaining such relationships when an existing relationship becomes high-risk); (e) enhanced due diligence on politically exposed persons (including, among other things, escalation to the bank's senior management level of decisions on entering into business relationships with these persons); and (f) clear rules on what records must be kept on CDD and individual transactions and their retention period. Such records have at least a five-year retention period.
Description and findings re EC5	Article 23 of the AML/CFT Law states that banks should have in place and apply "internal legal statutes" (policies, concept papers, rules, regulations, procedures, instructions or other means) aimed at the prevention of ML/TF, having regard to the size and nature of the reporting entity's activities and risks. They should establish:

⁶⁵ Consistent with international standards, banks are to report suspicious activities involving cases of potential money laundering and the financing of terrorism to the relevant national center, established either as an independent governmental authority or within an existing authority or authorities that serves as an FIU.

- 1) Procedures to enable customer due diligence (including enhanced and simplified due diligence), and to maintain information;
- 2) List of required documents and other information to conduct customer due diligence (including enhanced and simplified due diligence);
- 3) Procedures for collecting, recording, and maintaining information on customers, transactions and business relationships;
- 4) Procedures for recognizing a transaction or business relationship as suspicious;
- 5) Adequate procedures to manage the potential and existing risks, which may arise in relation to the development of new products and new business practices, to the use of new or developing technologies, as well as to non-face to face transactions or business relationships;
- 6) Procedures for effective risk management to establish the presence of high-risk criteria, including the circumstance where the customer is a politically exposed person, or a family member of or otherwise associated with such person;
- 7) Procedures for effective risk management in case of establishing a business relationship or conducting an occasional transaction without a prior verification of identity.

According to Part 1 of Article 22 of the AML/CFT Law, banks should maintain the information and documentation required under the Law, including when obtained in the course of customer due diligence, regardless of whether the transaction or business relationship is ongoing or has been terminated, and inclusive of:

- 1) Customer identification data, including data on the account number and turnover, as well as business correspondence data;
- 2) All necessary records on transactions or business relationships, both domestic and international (including the name, the registration address (if available) and the place of residence (domicile) of the customer (and the other party to the transaction), the nature, date, amount, and currency of transaction and, if available, type and number of the account, which would be sufficient to permit full reconstruction of individual transactions or business relationships;
- 3) Information on suspicious transactions or business relationships as specified under Article 7 of the AML/CFT Law, as well as information concerning the process of review (conducted analysis) and findings on transactions or business relationships not recognized as suspicious;
- 4) Findings of the assessment of potential and existing risks specified under Article 4 of the AML/CFT Law;
- 5) Information specified under Article 20 of the AML/CFT Law (Obligations related to wire transfers);
- 6) Other information stipulated by the AML/CFT Law.

With regard to EC 5(e), according to Article 3 of the AML/CFT Law, foreign politically exposed persons are considered to be high risk. According to Article 18 of the AML/CFT Law, in the presence of high-risk criteria, banks should conduct enhanced customer due diligence. According to Article 3 of the AML/CFT law, enhanced customer due diligence shall be a process involving advanced application of customer due diligence by the reporting agency, whereby at minimum, it is required to:

- 1) Obtain senior management approval to establish a business relationship with the customer, to continue the business relationship, as well as when the customer or the beneficial owner is subsequently found to be characterized by high-risk criteria, or when the transaction or the business relationship is found to comprise such criteria;
- 2) Take necessary measures to establish the source of funds and wealth of the customer;
- 3) Examine, as far as possible, the background and purpose of the transaction or business relationship;

	<p>4) Conduct enhanced ongoing monitoring of relationships with politically exposed persons.</p> <p>However, there continues to be no legal requirements to implement enhanced due diligence measures on politically-exposed persons (PEPs).</p> <p>According to Part 2 of Article 22 of AML/CFT Law, information and documentation specified under Part 1 should be maintained for at least 5 years following the termination of the business relationship or completion of the transaction.</p> <p>When on-site, supervisors are required to verify implementation of these procedures and they perform random testing. Since the RBS approach has been adopted, on-site examinations are not as frequent. They however are focused on banks classified as high risks and higher risk than medium.</p>
EC6	<p>The supervisor determines that banks have in addition to normal due diligence, specific policies and processes regarding correspondent banking. Such policies and processes include:</p> <p>(a) gathering sufficient information about their respondent banks to understand fully the nature of their business and customer base, and how they are supervised; and</p> <p>(b) not establishing or continuing correspondent relationships with those that do not have adequate controls against criminal activities or that are not effectively supervised by the relevant authorities, or with those banks that are considered to be shell banks.</p>
Description and findings re EC6	<p>According to Article 19 of the AML/CFT Law, in the course of correspondent or other similar relations with foreign financial institutions, in addition to the requirements defined by the Law with regard to customer due diligence, financial institutions should also undertake the following:</p> <ol style="list-style-type: none"> (1) Gather sufficient information about the respondent institution to understand fully the nature of the respondent's business and, based on publicly available and other reliable information, determine the reputation of the respondent institution and the quality of its supervision, including whether it has been or is subject to a criminal investigation or other proceeding related to money laundering or terrorism financing; (2) Assess the respondent institution's procedures to ascertain that they are adequate and effective; (3) Obtain the approval of senior management before establishing a correspondent or other similar relationship; (4) Document the respective responsibilities of each institution with regard to combating ML/TF, if such responsibilities are not apparently known; (5) Ascertain that, in connection with payable-through accounts, the respondent institution: <ol style="list-style-type: none"> a. Has conducted due diligence of customers having direct access to the accounts of the financial institution and is able to provide upon request relevant data regarding the due diligence of these customers; b. Does not allow the use of its accounts by shell banks. <p>Financial institutions are prohibited from entering into or continuing correspondent or other similar relations with shell banks.</p>
EC7	<p>The supervisor determines that banks have sufficient controls and systems to prevent, identify and report potential abuses of financial services, including money laundering and the financing of terrorism.</p>
Description and findings re EC7	<p>Article 24 of the AML/CFT Law requires banks to have an Internal Monitoring Unit. Staff members of the Internal Monitoring Unit should have appropriate qualification awarded on the basis of qualification rules and professional competence criteria defined by the Authorized Body. The Internal Monitoring Unit shall make the final decision on recognizing a transaction or business relationship as suspicious, on suspending, refusing, or terminating a transaction or business relationship, and on freezing the property of terrorism-related persons. It shall also</p>

ensure submission of the reports to the Authorized Body as defined by this Law, and implementation of other functions by the reporting entity as established by this Law and the legal statutes adopted on the basis thereof. The Internal Monitoring Unit should have direct and timely access to the information (including documents) obtained and maintained by the reporting entity under the AML/CFT Law. The Internal Monitoring Unit shall, on a regular basis but at least semi-annually, review the compliance of the transactions conducted and business relationships established by the reporting entity, as well as of the activities of its structural and territorial units and employees with this Law and the legal statutes adopted on the basis thereof. The Internal Monitoring Unit shall present a report to the competent body of the reporting entity specified by the Authorized Body (in banks—to the Board) on the findings of the review, as well as on other issues proposed by the Authorized Body. In performing its functions under this Law and the legal statutes adopted on the basis thereof, the Internal Monitoring Unit shall be independent and have the status of senior management of the reporting entity.

According to Article 7 of the AML/CFT Law, banks should recognize a transaction or business relationship, including an attempted transaction or business relationship, as suspicious and file with the Authorized Body a report on suspicious transaction or business relationship as stipulated under Article 8 of the Law, if it is suspected or there are reasonable grounds to suspect that the property involved is the proceeds of a criminal activity or is related to terrorism, terrorist acts, terrorist organizations or individual terrorists, or to those who finance terrorism, or was used in or is intended to be used for terrorism, or by terrorist organizations or individual terrorists, or by those who finance terrorism.

AML/CFT inspections were conducted within the full-scope inspection plan until 2017. In 2015 and 2016, main findings of those inspections related to the AML/CFT area, which led to sanctions (see EC8), were as follows as reported by examiners:

- Inadequate internal reporting. Reports on findings presented to the competent body of banks lacked the information required by legislation (e.g., number of transactions subject to mandatory reporting, number and brief description of transactions suspended, refused or terminated, the cases of violating requirements of laws and regulations due to the actions of staff members of the bank). This requirement is stipulated in the AML/CFT Law and the Regulation on minimum requirements to reporting entities in the field of preventing ML/TF.
- Failure to organize training for newly hired staff in prevention of ML/TF. This requirement is defined in the Regulation on minimum requirements to reporting entities in the field of preventing ML/TF.
- Failure to ensure proper risk assessment of customers and transactions. This requirement is defined in the Regulation on minimum requirements to reporting entities in the field of preventing ML/TF.
- Failure to properly identify certain customers as high risk. This requirement is defined in the Law on combating ML/TF.
- Failure to gather sufficient information on foreign financial institutions (respondent institution) to understand fully the nature of respondent institution's business and determine the reputation and the quality of its supervision. This requirement is defined in the Law on combating ML/TF.
- Failure to report transactions subject to mandatory requirements. This requirement is defined in the Law on combating ML/TF.

In 2017, targeted inspections were carried out to assess the accuracy and effectiveness of the processes aimed at automatically comparing counterparties with persons included in terrorism-related person lists and blocking their transactions in case of matching. Findings were

	documented and sent to banks together with recommendations for corrective actions and requirement to present a reasonable schedule for implementation of necessary changes.																				
EC8	The supervisor has adequate powers to take action against a bank that does not comply with its obligations related to relevant laws and regulations regarding criminal activities.																				
Description and findings re EC8	<p>According to Article 30 (Part 2) of the AML/CFT Law, non-compliance or inadequate compliance with the requirements of the Law or the legal statutes adopted on the basis thereof by financial institutions shall result in corrective measures, as established by the legislation regulating their activities, in the manner provided for under such legislation (Article 39.7 of the LCB, Articles 60-65 of LBB, Article 10 of the Currency Control Law).</p> <p>According to Article 31 of AML/CFT Law involvement of legal persons that are banks in money laundering shall result in a fine equal to the 5,000-fold amount of the minimum salary and may also result in revoking or suspending or terminating the person's license, or in bringing a suit to the court for dissolving the legal person in the manner established by the law. Involvement of legal persons that are banks in terrorism financing shall result in a fine equal to the 20,000-fold amount of the minimum salary, as well as in revoking or terminating the person's license, or in bringing a suit to the court for dissolving the legal person in the manner established by the law.</p> <p>Sanctions imposed on banks in the area of AML/CFT over the last 3 years based on on-site inspections and off-site supervision are the following:</p> <table border="1"> <thead> <tr> <th>Type of violation</th> <th>2015</th> <th>2016</th> <th>2017</th> </tr> </thead> <tbody> <tr> <td>Resulting in warning</td> <td>11</td> <td>8</td> <td>1</td> </tr> <tr> <td>Resulting in warning and fine</td> <td>1</td> <td>7</td> <td>13</td> </tr> <tr> <td>Notification with an assignment to take relevant measures for excluding such violations in future</td> <td>11</td> <td>9</td> <td>3</td> </tr> <tr> <td>Total</td> <td>23 violations, AMD 500,000 fine</td> <td>24 violations, AMD 1,1 million fine</td> <td>17 violations, AMD 3,3 million fine</td> </tr> </tbody> </table>	Type of violation	2015	2016	2017	Resulting in warning	11	8	1	Resulting in warning and fine	1	7	13	Notification with an assignment to take relevant measures for excluding such violations in future	11	9	3	Total	23 violations, AMD 500,000 fine	24 violations, AMD 1,1 million fine	17 violations, AMD 3,3 million fine
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EC9	<p>The supervisor determines that banks have:</p> <ul style="list-style-type: none"> (a) requirements for internal audit and/or external experts⁶⁶ to independently evaluate the relevant risk management policies, processes and controls. The supervisor has access to their reports; (b) established policies and processes to designate compliance officers at the banks' management level, and appoint a relevant dedicated officer to whom potential abuses of the banks' financial services (including suspicious transactions) are reported; (c) adequate screening policies and processes to ensure high ethical and professional standards when hiring staff; or when entering into an agency or outsourcing relationship; and (d) ongoing training programs for their staff, including on CDD and methods to monitor and detect criminal and suspicious activities. 																				
Description and findings re EC9	a) According to Article 25 of the AML/CFT Law, banks should conduct internal audit in the cases and at the periodicity established by the Authorized Body, to ascertain adequate implementation of the obligations and functions established by the AML/CFT Law. In the																				

⁶⁶ These could be external auditors or other qualified parties, commissioned with an appropriate mandate, and subject to appropriate confidentiality restrictions.

	<p>manner established by the Authorized Body, upon the request of the Authorized Body or by their own initiative, banks shall commission external audit to ascertain implementation of the legislation on combating ML/TF, and its effectiveness. According to Part 57, Chapter 9 of the CBA Regulation on minimum requirements to banks in the field of preventing ML/TF conclusions made by the audit shall be duly submitted to the CBA within one week following approval by the Board of the reporting entity.</p> <p>b) See EC7 (Article 24 of the AML/CFT Law),</p> <p>c) & d) According to Article 23 of the AML/CFT Law, banks should have in place and apply internal legal statutes (policies, concept papers, rules, regulations, procedures, instructions or other means) aimed at the prevention of ML/TF, having regard to the size and nature of the reporting entity's activities, as well as the risks pertinent thereof. Internal legal statutes referred to in this Part should establish, at minimum: Requirements with regard to hiring, training, and professional development of the staff members of the Internal Monitoring Unit and other employees in connection with the obligations (including customer due diligence and reporting of suspicious transactions or business relationships) defined by the legislation on combating and other legal statutes, as well as in connection with potential and existing risks and typologies.</p> <p>Moreover, according to Chapter 10 of the Regulation, the reporting entity should arrange regular training for the Board, the Executive Body, the Internal Monitoring Unit, the staff performing customer service and internal audit functions, as well as for other relevant staff with competencies in the prevention of ML/TF. Training in the prevention of ML/TF for the newly recruited staff should be arranged within three months after their recruitment.</p> <p>According to Article 18 and Article 22 of the Banking Law the CBA introduces fit and proper checks for banks, which prevent criminals and their associates from holding or being the beneficial owner of a significant or controlling interest (10% or more of the voting rights), or holding a management function, thus ensuring that business is conducted in conformity with high ethical standards, laws and regulations.</p> <p>During inspections (see EC 7), examiners also conduct interviews of front office staff and gather information on training (areas, coverage) provided to the relevant staff.</p>
EC10	<p>The supervisor determines that banks have and follow clear policies and processes for staff to report any problems related to the abuse of the banks' financial services to either local management or the relevant dedicated officer or to both. The supervisor also determines that banks have and utilize adequate management information systems to provide the banks' Boards, management and the dedicated officers with timely and appropriate information on such activities.</p>
Description and findings re EC10	<p>According to Article 24 of the AML/CFT Law, banks shall be obligated to have an Internal Monitoring Unit. The Internal Monitoring Unit should have the authority to immediately report to the reporting entity's competent body as determined by the Authorized Body (in banks—to the Board) on the reporting entity's problems with regard to ML/TF, as well as to participate in its consideration of the issues related to the prevention of ML/TF.</p> <p>The Internal Monitoring Unit shall, on a regular basis but at least semi-annually, review the compliance of the transactions conducted and business relationships established by the reporting entity with this Law and the legal statutes adopted on the basis thereof. The Internal Monitoring Unit shall present a report to the competent body of the reporting entity (in banks—to the Board) on the findings of the review, as well as on other issues proposed by the Authorized Body.</p> <p>Moreover, according to Part 17, Chapter 3 of the Regulation, the report on the findings of the review presented to the competent body of the reporting entity, at least comprise:</p>

	<ol style="list-style-type: none"> (1) The number of the transactions subject to mandatory reporting, the number and the brief description of suspicious transactions and business relationships; (2) The number and the summary description of the transactions and business relationships, which were analyzed but were not recognized as suspicious; (3) The number and the brief description of the transactions and business relationships suspended, refused or terminated by the reporting entity; the value of each suspended transaction or business relationship; (4) The value of frozen property; (5) The cases of violating requirements of the Law, this Regulation and other legal statutes adopted on the basis of the Law due to the actions of staff members of the reporting entity; (6) Other information stipulated by internal legal statutes.
EC11	Laws provide that a member of a bank's staff who reports suspicious activity in good faith either internally or directly to the relevant authority cannot be held liable.
Description and findings re EC11	According to Article 30 of the AML/CFT Law, banks (including their Boards or employees) cannot be subject to criminal, administrative or other liability in case of duly performing their obligations under the AML/CFT law.
EC12	The supervisor, directly or indirectly, cooperates with the relevant domestic and foreign financial sector supervisory authorities or shares with them information related to suspected or actual criminal activities where this information is for supervisory purposes.
Description and findings re EC12	<p>Article 39.1(1) of the Law on CBA empowers CBA to transfer all lawfully possessed information to other relevant foreign bodies for the purpose of prevention of law violations or prosecutions. The LCB provides general regulation of international cooperation between the CBA and foreign counterparts, whereas details on the specific ways of cooperation are provided by international or bilateral agreements signed by the CBA. Hence, there are no limitations for the CBA to proceed with requests or conduct any supervisory activity including conducting inquiries on behalf of foreign counterparts.</p> <p>There are no limitations in the legislation for the foreign financial supervisory bodies to conduct inquiries themselves in order to facilitate effective supervision of financial groups.</p> <p>According to Article 28 of the LCB, supervisory information constitutes classified information (official secrecy).</p> <p>As for the cooperation between the supervisors and FIU, see EC 4.</p> <p>Article 13 and Article 14 of the AML/CFT Law respectively, regulate national and international cooperation in the field of AML/CFT. In order to effectively combat ML/TF, the Authorized Body shall cooperate with other state bodies in the manner and within the framework established by the Law, including cooperation with supervisory and criminal prosecution authorities. The Authorized Body shall cooperate with supervisory authorities in the manner established under Article 29 of the Law to ensure compliance of the banks with the requirements of the Law and the legal statutes adopted on the basis thereof.</p> <p>According to Article 14 of the AML/CFT Law, the Authorized Body and relevant state bodies shall cooperate with international structures and relevant bodies of foreign countries (including foreign financial intelligence bodies) involved in combating ML/TF within the framework of international treaties or, in the absence of such treaties, in accordance with international practice.</p>
EC13	Unless done by another authority, the supervisor has in-house resources with specialist expertise for addressing criminal activities. In this case, the supervisor regularly provides information on risks of money laundering and the financing of terrorism to the banks.

Description and findings re EC13	According to Part 3 of Article 13 of the AML/CFT Law the Authorized Body shall submit a notification to criminal prosecution authorities, when, based on the analysis of a report filed by a reporting entity or of other information in the manner established by this Law, it arrives at a conclusion on the presence of reasonable suspicions of money laundering or terrorism financing. Along with the notification the Authorized Body may submit further data to criminal prosecution authorities. The notification or the additionally submitted data may contain classified information as defined by the law.
Assessment of Principle 29	Largely Compliant
Comments	<p>Compared to the situation prevailing in 2012 before the 49th plenary session of the MONEYVAL Committee which adopted in December 2015 the Fifth Round Mutual Evaluation Report on the Armenian AML/CFT system, a most robust legal and regulatory framework is in place following several changes in the laws and regulations. Armenia has introduced a risk-based approach to AML/CFT supervision in the banking sector and implementation is in progress. The FMC is considered to be provided with skilled human resources and technical tools and procedures.</p> <p>The cooperation between supervisors and the FMC is close with joint inspections being organized. The FMC used to take part in every full-scope inspection. With the implementation of the risk-based approach, targeted inspections will be the norm and they will be jointly conducted in close cooperation with the Risk Team in charge of Operation risk and AML/CFT in the FSD department.</p> <p>To complete the current implementation of the CBA AML/CFT risk-based approach, assessors consider it necessary for the FMC to develop a specific AML/CFT risk-based supervision manual. The frequency of on-site examinations should also be increased compared to the current situation (only one targeted examination during the 2018 first semester in one of the banks where inherent risk is high).</p> <p>There continues to be no legal definition for domestic politically-exposed persons (PEPs). Amendments to the AML/CFT law should be made to introduce the definition of domestic PEPs and explicitly require that enhanced due diligence measures are implemented in case of high-risk business relationships with PEPs, including domestic PEPs.</p>

SUMMARY OF COMPLIANCE WITH THE BASEL CORE PRINCIPLES

Core Principle	Grade	Comments
1. Responsibilities, objectives and powers	C	The banking supervisory responsibilities and objectives of the CBA are clearly enshrined in legislation. There is no evidence to suggest that the dual mandates of financial stability and price stability are compromising the setting of prudential standards. Clarity regarding the roles of the two deputy chairmen regarding bank supervision can be improved.
2. Independence, accountability, resourcing and legal protection for supervisors	C	<p>It is recommended that the CBA enhance its disclosure of specific supervisory objectives and the outcomes of activities designed to meet those objectives.</p> <p>In addition to providing training to existing staff, as additional staffing needs are identified consideration should be given to hiring individuals with prior experience/training in risk analytics, stress testing, and risk management.</p>
3. Cooperating and collaboration	LC	<p>The authorities should consider publishing the MOU with the MOF and DGF to ensure information sharing, coordination, cooperation and also promote greater accountability and transparency.</p> <p>The MOUs with the foreign supervisors should be revisited to refer to handling problem financial institutions and to the resolution of failing banks, as prescribed by the latest recommendations of the Basel Committee and the Financial Stability Board (FSB). Formal procedures or processes should be agreed between the CBA and relevant supervisors on how a bank would be resolved in practice.</p>
4. Permissible activities	C	Only banks can accept deposits and can provide banking activities defined as both accepting deposit and extending credit. Non-banking financial institutions are not allowed to take deposits.
5. Licensing criteria	C	Current laws and regulations cover all the key elements of an effective licensing framework and the approach to assessing the fitness and propriety of major shareholders and senior management of an applicant bank is appropriate. During the interview process, Chief Risk Officer and

Core Principle	Grade	Comments
		Head of the compliance functions are not yet included, but CBA has prepared a draft amendment to be able to do so.
6. Transfer of significant ownership	C	The CBA has the appropriate powers to approve and reject applications by prospective owners to become substantial shareholders of a bank on both a consolidated and solo bank basis.
7. Major acquisitions	C	The CBA has the legal powers to approve or reject acquisitions or investments by a bank. As part of the consolidation of the Armenian banking system, the CBA reviewed and approved four requests for acquisitions linked to mergers of banks since the last assessment.
8. Supervisory approach	LC	The CBA formally adopted a risk-based supervision program (RBS) in December 2017 after a three-year pilot. The RBS requires an annual comprehensive risk assessment of each bank that includes: identification of material operations and evaluation of inherent risks and mitigating management controls. The “net risk” is assessed against the adequacy of capital and liquidity. Supervisory activities are planned out annually based on needs for validating risks and controls. The program design appears comprehensive and provides for forward looking assessments, proportionate allocation of resources, assessments of risks for both individual firms and across the system, and incorporation of macroeconomic factors. The program is now in its first cycle and while gaps in supervisory information were identified, plans are directed towards addressing those areas. Shortcomings in the EC included no assessments of resolvability and lack of a specific framework for weak banks (PCA).
9. Supervisory techniques and tools	LC	The extent of onsite validation inspections vs off-site analysis activities needs better balance. Prudential inspections have been limited the past two years due in part to training and process development for RBS. The 2018 plan appears to have better balance and should reduce information gaps evident in the existing risk assessments. Also, risk teams are increasing their activities in response to needs for improved structural (system-wide) in assessing risk in material operations and providing additional guidance to general examiners.

Core Principle	Grade	Comments
10. Supervisory reporting	C	Reporting is extensive and based on IFRS, although the CBA imposes a separate supervisory regime for asset classifications that determine provisioning, reserves and write-offs. Reports enable monitoring of prudential standards for capital, liquidity, asset quality, large exposures and FX positions. The CBA has access to a credit registry which enables near real-time monitoring of loan portfolios, including individual borrowers.
11. Corrective and sanctioning powers of supervisors	LC	The laws and regulations provide the CBA with sufficient tools to address unsafe and unsound practices within a bank or banking group in a timely fashion. CBA should develop a Prompt Corrective Action framework and disclose it to all stakeholders. A Prompt Corrective Action requirement should prescribe mandatory and discretionary supervisory actions to be taken when an institution breaches specified capital thresholds and triggers. The corrective action framework should be reviewed with a view to facilitating the decision to trigger and achieve an orderly resolution. Revisiting the current resolution framework to allow the CBA to develop a regime specifically dedicated to banks in line with the Key attributes of the FSB should be helpful in this regard.
12. Consolidated supervision	C	Laws and regulations were enacted to classify affiliated entities as “financial groups”. The regulations give CBA discretion to distinguish its supervisory approaches among complex/not low risk groups and low risk groups. All banking groups, irrespective of their risk classification, are required to submit <ul style="list-style-type: none"> • consolidated financial statements, • consolidated comprehensive income statements, • report on foreign exchange positions, • report on intra-group transactions. In addition to these reports, if classified not low risky, they also submit reports on prudential standards. Low risk groups are supervised on a solo basis, although all groups are subject to reporting inter-group transactions. Currently there are no complex/not low risk groups.
13. Home-host relationships	LC	No Armenian banks currently have foreign operations. Subsidiaries of four foreign

Core Principle	Grade	Comments
		banks operate locally. Supervisors attend supervisory colleges when invited. To date there has been no discussion of group resolution plans with home supervisors. It is recommended that for foreign owned large banks the CBA reach out to home supervisors to gain an understanding of their recovery/resolution frameworks. MOUs should be updated as necessary to accommodate sharing of resolution related information.
14. Corporate governance	LC	Regulations and guidelines generally provide an adequate framework; however, there is a need to build out more structured (system-wide) understanding of practices across firms.
15. Risk management process	LC	There have been significant changes in laws and regulation that provide flexibility for the CBA to conduct and enforce the RBS. Regulations require banks to have the essential elements for comprehensively identifying and managing risk, including stress testing capabilities and ICAAP processes. CBA is undertaking a review of its regulations with industry input to align them with better practices in the industry. Supervisory field work to validate risk management systems and fill information gaps is ongoing, but more needs to be done to assess the supervisor's knowledge as fully sufficient. As stress testing is an increasingly important component of the assessment process it is recommended that written guidance be articulated for reviewing methodologies and results.
16. Capital adequacy	LC	The current capital adequacy requirement applied to all banks in Armenia is mostly based on the components of the standardized approach of Basel II (while the quality requirements for elements included in regulatory capital are consistent with the Basel III requirements,). The CBA is implementing a Basel III plan, which should lead to Basel III full compliance in the next 5 years. As a practical matter, almost all capital of Armenian banks is CET1 as there is only a small market for subordinated or hybrid instruments. Armenian banks are already required to maintain a total capital of 12 percent and in most cases report significantly higher capital, so there should be no practical difficulty meeting Basel III capital requirements over such period.

Core Principle	Grade	Comments
		<p>CBA has adopted and is in the process of adopting other elements of Basel III (capital buffers and potentially a leverage ratio). Capital is calculated on a consolidated and solo basis for all banks and CBA has the authority to impose additional capital requirements on individual banks, as deemed necessary, but it has not yet set minimum capital ratios for banks based on their risk profile. Also, CBA has not introduced a leverage ratio as previous simulation had shown a sector level of 13% in 2011, and 12.4 in 2017 (calculated based on Basel methodology), but it has started discussing the introduction of such a ratio, because recent analysis as shown greater divergence between banks. However, the lowest level of the leverage ratio in the banking system (5.3%) is quite above the Basel minimum level (3%), not making the introduction of the ratio as high priority. No draft regulation has been prepared yet. Banks are required to use their own ICAAP results to detect whether their existing capital is enough to withstand the bank's risks, but CBA does not receive nor challenge the outcome of these exercises.</p>
17. Credit risk	LC	<p>Credit risk is monitored through the on-site inspection process as well as off-site via reports and access to data in the credit registry. Supervisors sample credit files for review during inspections. Monthly, banks are required to submit classifications of loans based the supervisors five grade scale. Supervisors have been known to challenge classifications and the adequacy of reserves. Practices and procedures for assessing credit risk are generally adequate. However, unhedged FX loans represent substantial risk to the banking system. The CBA should closely monitor the implementation of its new regulation requiring banks to identify and track unhedged borrowers based on a common supervisory definition and consider developing more formal reports from banks.</p>
18. Problem assets, provisions, and reserves	LC	<p>The CBA has a longstanding practice of requiring classifications of credits within a five-grade system based on delinquency and with a qualitative adjustment for borrowers experiencing financial distress. Provisions and reserves are largely driven in a formulaic manner from those classifications, although qualitative adjustments are also made. With</p>

Core Principle	Grade	Comments
		the adoption of IFRS 9 by all banks this year, it is recommended that CBA evaluate whether there are opportunities to leverage from IFRS reporting systems for assessing loan quality and reserves. At a minimum, supervisors should be assessing IFRS 9 methodologies for managing credit risk. CBA also uses a non-standard (more conservative) definition for NPLs (1-day delinquent) and renegotiated loans. BCBS guidance released April 2017 provides standardized regulatory definitions that should be adopted to provide users of bank financial data a clearer picture of the condition of the banking system. The CBA should also collect information on restructured loans as part of its regular reporting.
19. Concentration risk and large exposure limits	MNC	A number of banks have been identified as breaching the large exposure limits. Although sanctions/fines have been levied in some cases, these have apparently not been sufficient to prevent further violations. The inconsistency in the application of sanctions for all breaches is problematic. The CBA should review its enforcement practices with regard to large exposure limits with an aim towards consistently applying sanctions and having banks operate within prescribed limits.
20. Transaction with related parties	LC	As only very few full scope on-site examinations have been performed in the last 5 years, the CBA should consider undertaking further review of related party lending reporting to ensure that banks and banking groups are capturing all connected loans under the current legislation.
21. Country and transfer risks	LC	Based on its monitoring, the CBA considers country risk to be low for the Armenian banking system, therefore it has not been of high priority for the authorities. CBA has however introduced a range of general requirements to the risk management function of banks in assessing, monitoring and managing different types of risk, not included in Pillar 1, including country risk.
22. Market risk	LC	Supervisors have inspection activities planned to establish a system-wide assessment of the level of bank compliance with BCBS recommended practices. Compliance with recently introduced regulations regarding the use of internal models also needs to be evaluated. CBA

Core Principle	Grade	Comments
		should evaluate the January 2016 BCBS Standards, "Minimum Capital Requirements for Market Risk" and the June 2017 consultative document "Simplified alternative to the standardized approach to market risk capital requirements." While CBA is considered in compliance with 2006 Basel II standardized approaches, there is some concern that those standards may not be sufficiently dynamic to address the growth in interest rate risk. In addition to evaluating the 2016 changes, the CBA should better integrate IRR stress testing into Pillar 2 capital requirements.
23. Interest rate risk in the banking book	LC	IRRBB is generally evaluated against older Basel guidance. CBA should evaluate the need to incorporate, as appropriate to their jurisdiction, the recommendations in the 2016 Basel Standards for IRRBB Adoption of the 2016 guidance would introduce: more extensive guidance on the expectations for a bank's IRRBB management process in areas such as the development of interest rate shock scenarios, as well as key behavioral and modelling assumptions; disclosure requirements to promote greater consistency, transparency and comparability; an updated standardized framework; and a stricter threshold for identifying outlier banks.
24. Liquidity risk	C	Although the CBA's approach to supervising liquidity risk is rated compliant with requirements of the Core Principles, it is recommended that the CBA adopt the LCR and NSFR ratios.
25. Operational risk	LC	Recently reinforced with the creation of a Risk team dedicated to Operational risk, the activities of FSD in this domain indicate extensive focus on operational risk and risk management in the last two years (survey of top 10 risks in the banks in 2017, thematic examination on data bases, on-site examination in 9 banks in 2018). Greater prudential focus is the main outcome compared to the previous procedures focused on topics such as physical security and branch inspections, that are better addressed by the banks' own internal audit functions. This allows dedicate examiners resources to the risks more likely to threaten the soundness of the bank. FSD has a clear view of the operational risks in the system and in each individual bank, though this

Core Principle	Grade	Comments
		knowledge must still be confirmed through the coming on-site focused examinations scheduled under the RBS framework. It remains for CBA to formally issue its draft regulation on outsourcing activities.
26. Internal control and audit	C	Policies and procedures for evaluating internal control, compliance and internal audit functions appear adequate.
27. Financial reporting and external audit	C	Banks are required to be audited annually by a firm applying international auditing standards. In practice, only internationally recognized big firms (EY, PWC, KPMG, Deloitte, Grant Thornton Armenia) are permitted to audit banks. All public reporting is under IFRS.
28. Disclosure and transparency	C	All banks are audited annually under IFRS and make required disclosures.
29. Abuse of financial services	LC	A robust legal and regulatory framework is in place following several changes in the laws and regulations. Armenia has introduced a risk-based approach to AML/CFT supervision in the banking sector and implementation is in progress. The FMC is considered to be provided with skilled human resources and technical tools and procedures. However, there continues to be no legal requirement to implement enhanced due diligence measures on politically-exposed persons (PEPs). Amendments to the AML/CFT law should be made to introduce the definition of domestic PEPs and explicitly require their identification and the implementation of those enhanced due diligence measures in case of high-risk business relationships.

RECOMMENDED ACTIONS AND AUTHORITIES' COMMENTS

A. Recommended Actions

The authorities should give priority to:

- Continue refining risk based supervisory approaches for more granular assessments of banks capital needs,
- Adopt Basel guidance for asset quality metrics used by CBA and banks
- Adopt Basel III requirements for buffers and liquidity

- Actively engage in assessing IFRS 9 requirements for estimating expected losses and provisions in credit risk management assessments
- Broaden home/host communications to encompass resolution strategies, enterprise-wide risk management issues
- Broaden disclosure of thematic work and risks identified across the banking system
- Develop/disclose framework for weak banks/PCA
- Strengthen use of ad hoc enforcement measures.
- Strengthen stress testing analytics among supervision staff.

Reference Principle	Recommended Action
Principle 2 Central Bank Independence	It is advised that the CBA Law be revised so that the statutory requirements that the reasons for removal of the Governor or a Board member be publicly disclosed are contained in the CBA Law itself
Principle 3 Cooperation and collaboration	<p>Consider publishing the MOU signed by CBA with the MOF and DGF to ensure information sharing, coordination, cooperation and also promote greater accountability and transparency.</p> <p>Revisit MOUs with foreign supervisors to refer to handling problem financial institutions and to the resolution of failing banks, as prescribed by the latest recommendations of the Basel Committee and the Financial Stability Forum.</p>
Principle 8 Supervisory approach	<p>Continue refining the risk-based supervisory approach for more granular assessments of each firm capital needs. Build-out more structural (system-wide) assessments of significant risk areas and mitigating controls.</p> <p>Conduct resolvability reviews of larger banks.</p> <p>See Principle 11 regarding adoption of an early intervention Prompt Corrective Action framework.</p>
Principle 9 Supervisory techniques and tools	Annual supervisory plans should be reviewed to ensure that 1) a better balance between off-site analysis and on-site validation is achieved, and 2) a priority is placed on addressing knowledge gaps identified in the planning process.
Principle 11 Corrective and sanctioning powers of supervisors	Develop a non-discretionary Prompt Corrective Action framework of supervisory actions taken in response to a bank's deteriorating capital or liquidity position. Such responses may include submission of remediation plans, ceasing dividends and discretionary compensation, and limits on growth, types of activities, or funding sources.
Principle 13 Home-host relationships	Broaden home/host communications to encompass resolution strategies and risk management activities conducted at the parent for the local subsidiary. MOUs should be updated as necessary to accommodate sharing of such information.

Reference Principle	Recommended Action
Principle 14 Corporate governance	Continued emphasis should be placed on implementation of supervisory guidance and building out more structural (system-wide) understanding of practices across all banks.
Principle 15 Risk management process	Review/update regulations considering developments in the banking system and new BCBS guidance (IRRBB, problem asset definitions, Basel III). Recommend standardizing criteria for assessing bank-run stress test methodologies and results.
Principle 16 Capital adequacy	The CBA should complete adoption of Basel III capital buffers. CBA should enhance its review of bank ICAAP processes and more comprehensively implement its Pillar 2 approach, though implementation of the risk-based approach is a significant step forward.
Principle 17 Credit risk	Review banks implementation of controls for identifying and monitoring unhedged FX borrowers using the new supervisory definition; develop formal reporting for unhedged FX exposures.
Principle 18 Problem assets, provisions and reserves	Address use of non-standard definitions for NPL and restructured loans based on 2017 Basel guidance. Institute formal reporting on restructured loans. Evaluate whether greater convergence can be achieved between IFRS and supervisory reporting; have supervisors focus on evaluating credit risk management systems required under IFRS 9.
Principle 19 Concentration risk and large exposure limits	The CBA should review its enforcement practices with regard to large exposure limits with an aim towards consistently applying sanctions and having banks operate within prescribed limits.
Principle 20 Transactions with related parties	Consider undertaking a thematic review of related party lending reporting to confirm current work that banks and banking groups are capturing all connected loans under the current legislation. Avoid warning bank owners with several days (5 days under Article 27.2 and 3 days under Article 29.1), of pending liquidation, a period in which, if CBA supervisors are not on-site monitoring transactions and granted authorization to block transactions (especially insider and related party), insiders have a golden opportunity for asset-stripping.
Principle 21 Country risk	Assess implementation by banks of the new requirements and, in the absence of specific regulatory requirement, adequacy of banks policy in managing and setting limits for country risks.
Principle 22 Market risk	<ul style="list-style-type: none"> • CBA should evaluate the January 2016 BCBS Standards, “Minimum Capital Requirements for Market Risk” and the June 2017 consultative document “Simplified alternative to the

Reference Principle	Recommended Action
	<p>standardized approach to market risk capital requirements” for application locally.</p> <ul style="list-style-type: none"> • CBA should consider better integrating IRR stress testing into Pillar 2 capital requirements. • Continued emphasis should be placed on development of supervisory guidance and building out system-wide understanding of practices across all banks. • On-site validation work should assess compliance with new requirements for use of internal models (Regulation 4).
Principle 23 IRRBB	Evaluate the need to incorporate, as appropriate to their jurisdiction, the recommendations in the 2016 Basel Standards for IRRBB that expands on risk management, stress scenarios, identification of outliers and disclosures.
Principle 25 Operational risk	Issue the draft regulation on outsourcing activities.
Principle 29 Abuse of financial services	<p>There continues to be no legal requirements to implement enhanced due diligence measures on domestic politically-exposed persons (PEPs). Amendments to the AML/CFT law should be made to introduce the definition of domestic PEPs and explicitly require their identification and the implementation of that enhanced due diligence measures in case of high-risk business relationships.</p> <p>The FMC should develop a specific AML/CFT risk-based supervision manual.</p> <p>The frequency of on-site examinations should also be increased compared to the current situation (only one targeted examination during the 2018 first semester in one of the banks where inherent risk is high).</p>

B. Authorities’ Response to Assessment

The Central Bank of Armenia (CBA) would like to express its appreciation to the International Monetary Fund (IMF), the World Bank (WB), and the Financial Sector Assessment Program (FSAP or Program) mission team for the comprehensive and detailed assessment under the FSAP. We believe the latter will promote soundness of the financial system of Armenia and contribute to improving supervisory practices, as was the case with previous Programs.

The CBA would like to specifically acknowledge professionalism shown and hard work performed by the FSAP mission team, which ensured successful completion of the assessment. It is also encouraging to read in the Report that the FSAP mission team emphasizes accomplishments of the CBA in enforcement

of compliance with Basel Core Principles and highly evaluates the achievements of the Central Bank in developing and implementing the Risk Based Supervision Framework.

We note that, the FSAP mission team made highly valuable recommendations, which would be addressed in the near future. The Central Bank confirms its strong commitment to undertaking adequate measures for continuous improvement and strengthening of the regulatory and supervisory frameworks of the Armenian banking system.