MEMORANDUM OF UNDERSTANDING

ARM: Proposed Public Efficiency and Financial Markets Program—Fact-Finding Mission (June 28-July 7, 2017)

A. Introduction

1. An ADB fact-finding mission (the mission) was fielded from June 28-July 7, 2017 to (i) agree on the policy matrix and the scope of the proposed public efficiency and financial market (PECM) program, (ii) discuss size and timing of the program, and (iii) collect data and information required for program documentation.[1] The mission met key stakeholders from the government, private sector and development partners including Ministry of Finance (MOF), Central Bank of Armenia (CBA), State Revenue Committee (SRC), International Monetary Fund (IMF), and European Bank for Reconstruction and Development (EBRD). Appendix 1 is the list of persons met.

2. This memorandum of understanding summarizes the mission's discussions with the Government of Armenia (the Government), which are subject to further iterations and approval by the Government and ADB management. Appendix 2 is the draft of the policy matrix.

B. Background

3. **Economic context.** The economic contraction in the Russian Federation continued to be a drag on Armenia's economic performance in 2016, through finance, trade and remittance channels. Economic growth slowed substantially to 0.2% in 2016 from 3.2% in 2015. These negative pressures led to a widening of the fiscal deficit to 5.5% of gross domestic product (GDP) in 2016 from 4.8% in 2015 and to further substantial debt accumulation to 56.6% of GDP from 48.7% in 2015. This fiscal position and the prevalence of foreign-currency public debt pose a significant source of risk exposure of public debt to exchange rate movements. Armenia faces the challenge of being fiscally responsible against a backdrop of slowing economic growth and a limited scope of further spending cuts. With the regional slow down and total public debt exceeding,[2] the next round of fiscal consolidation will have to be based on domestic revenue mobilization and public spending efficiency.

[1] The mission comprised Tariq Niazi, Principal Public Management Specialist/Mission Leader, Joao Pedro Farinha, Senior Financial Sector Economist, Matthew Hodge, Economist (Public Finance) from Central and West Asia Regional Department; and Grigor Gyurjyan, Economics Officer, Armenia Resident Mission (ARRM). The mission was supported by Shane Rosenthal, Country Director, ARRM.

[2] When the debt-to-GDP ratio is above 50%, the law stipulates a fiscal rule must be enforced which requires the budget deficit to be reduced as per a specific formula. For 2017, the fiscal rule requires the budget deficit to be reduced by approximately 3% of GDP.

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4. **The development problem.** The current economic environment is also creating pressure on the country's financial system. Increasing foreign inflows, exchange rate developments and under-developed capital markets played a role in increasing dollarization (around 60%) in the aftermath of the global financial crisis. High dollarization and consequent under development of financial markets in local currency has led to limited mobilization of long-term Armenian Dram (AMD) financing for investment by private and public sectors. The deepening of the domestic financial markets and increased financial intermediation in AMD thus assumes greater significance.[1] The core development problem that the PEFMP aims to address is rooted in a three dimensional interconnected constraints: (i) issues in public debt and fiscal risk management, and why it needs to become more credible, transparent and effective; (ii) challenges and institutional/infrastructure gaps that constrain the development of Armenia's government securities and money markets; and (iii) the lack of instruments and corporate governance practices that impede the broadening of the investor base in Armenia's corporate debt markets.

5. **Public debt and fiscal sustainability.** As Armenia moves to a middle income country, it no longer can easily access concessional financing and will have to increasingly rely on mobilizing debt from capital markets especially from domestic securities market. A transition from external, predominantly concessional, sources of finance to local currency-denominated government securities (currently 20%) is required over the medium term. A prudent debt management policy is needed to ensure that the financing needs of the government are met at a minimum cost but balanced against the need to grow the domestic debt market and reduce foreign exchange risk exposure. The debt management department functions without complete documented procedures and controls, or a risk management framework to manage its operational risk exposures. The management of fiscal activities is fragmented across ministries which lead to inconsistent treatment of risk exposures and inefficiencies in the absence of a centralized approach for fiscal risk management.

6. The lack of a fiscal risk framework for public debt management operations means that operational losses and the contingent liabilities of existing and future fiscal activities are not known and hence not well measured and monitored by the government. Security of the information system is inadequate to protect the integrity of data, and systems backup and business continuity arrangements are incomplete. Credit risk assessment and monitoring of on-lending, budgetary lending and guarantees is inconsistent and not always structured or priced according to the level risk the government is taking on. The government is increasingly using public–private partnerships (PPPs) for the provision of public services and infrastructure. There are no well-defined methodologies or procedures to effectively solicit, compare and vet PPP proposals in terms of costs, quality and risks. Legal risks also must be considered as PPPs imply future fiscal commitments which should be reflected in the PPP contract structure.[2]

7. **Government securities and financial market infrastructure.** The under developed financial markets in local currency is a fundamental constraint to private sector development (access to affordable finance), public debt and fiscal risk management, and to macroeconomic

[1] The deepening of the financial markets is driven by factors that include: (i) stable macroeconomic policies with a clear debt management strategy and management program to attract investors and stable fiscal and monetary policies to tackle external shocks and ensure financial stability, (ii) financial infrastructure to support efficient, transparent and low risk trading settlement and custody of securities, and availability of suitable financial instruments, (iii) strong legal and institutional environment to protect borrowers, creditor and investor rights, and promote corporate transparency and sound governance practices, and (iv) sequencing in market development. For example, government securities and money markets support development of the private debt and equity markets. IMF. 2014, *The Development of Local Capital Markets: Rationale and Challenges*. Washington D.C.

[2] PPP contracts can have direct liabilities (e.g. fixed payments), contingent liabilities (e.g. payments if a risk occurs), and implicit service delivery risks to the government.

and financial stability in general.[3] The nascent stage of the government securities market and the lack of key instruments and institutional mechanisms for secured interbank trading also impede the development of a more active money market. The expansion of the government securities market is essential for supporting the government's objective of generating additional investment opportunities in the economy by providing long term local currency instruments. A shift to domestic securities market not only provides government financing but also reduces exposure to exchange rate risks and contributes to the development of overall bond and equity markets in Armenia. Generally, the stimulation of financial markets requires the debt issuance program to be transparent, predictable and build liquid tranches of benchmark bonds that accommodate the government's financing needs while keeping currency, interest and refinancing risks at manageable levels. Specifically, the structuring of public debt issuances is of enormous importance in: (i) the actual development of a government securities market that can become more liquid over time and thereby provide investment opportunities for financial institutions, pension and other investment funds and foreign investors; (ii) providing opportunities for small investors to buy and sell retail government securities which provides a secure investment option; and (iii) the creation of market based pricing and reliable pricing benchmarks for private debt and equity markets to use as reference rates.

8. Armenia's money markets are underdeveloped, less liquid and do not support the development of active secondary markets through which efficient cash and liquidity management can be achieved. Secured interbank trading is shallow while the unsecured trading is minimal as perception of counterparty risks in the banking sector remains high. Promoting less credit intensive products such as repurchase agreements (repos) and an efficient liquid secondary market for treasury bills will mitigate the credit risk and is a crucial step forward for money-markets development. A Regular Treasury Bill Program (RTBP) with a constant supply of short term Treasury Bills (T-bills) issued in sufficient volume will support the further development of this market.[4] Development of the repo market is severely hindered by; (i) the short supply of marketable securities available to use as collateral in transactions; (ii) the use of non-standardized contractual terms; and (iii) manual transaction settlements which involves high transaction and monitoring costs. The development of liquid money markets is vital to underpin the deepening of the yield curve and capital markets development. The repo instrument also provides temporary liquidity for government bonds without the uncertainty and potential gains/losses associated with an outright sale in an illiquid secondary market. The enhancement of the money market infrastructure through a streamlined RTBP and more effective repos will promote the active and efficient use of T-bills and repos for cash and liquidity management.

9. The importance of the financial market development is recognized by the Armenian authorities. The government has established a Steering Committee for Capital Market development and a Task Force for Financial Market development. It is important to have a clearer division of mandate between the two bodies and a strategy for close interagency co-ordination and consultation with key stakeholders. This will allow the appropriate sequencing and a focused direction for financial market development in Armenia.

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[3] Financial dollarization of banks' assets and liabilities exposes banks to foreign exchange and refinancing risks. With limited financial deepening in AMD, both fiscal and monetary policies have little maneuvering space to tackle external macroeconomic shocks and to ensure financial stability. Consequently, the role of the exchange rate in macroeconomic and financial stability remains a core concern during external shocks.

[4] Under a RTBP 91, 180 and 365 bills are issued in regular fixed volumes which provide investors with a regular supply of short term T-Bills in sufficient volumes to meet demand for a short term low risk liquid instrument and support the secondary market.

10. **Investor base and corporate financial transparency.** There are only a few institutional investors in Armenia, such as pension funds and insurance companies that invest in the domestic capital market. There is dearth of domestic retail investors who could trade in small quantities of shares. This is because of a lack of retail access outside Yerevan and the absence of internet trading facilities that lower the transaction costs for small-volume trading. Also the absence of effective consumer and investor protection undermines retail investments. As a result, savings are not effectively channeled from the public to the financial markets through institutional investors and well-functioning markets. Due to historically low corporate transparency there is a general mistrust in the reliability of companies' accounts and audit of those accounts. This reflects deficiencies in the legal framework that governs sound corporate governance practices such as financial information transparency and the oversight of accounting and audit practitioners. This makes it difficult for investors to assess the incidence and magnitude of Armenian corporate risk. Weak corporate governance and a lack of complete and reliable financial information on domestic companies dissuades investors from actively participating in private financial markets. Strengthening of the legal framework to protect consumers and investors, improving corporate governance and introducing new types of securities will broaden the investor base and facilitate new investment opportunities for local and foreign investors in private equity and infrastructure, and make the financial sector more diversified.

11. **Government's reform agenda** Armenia's long-term development vision, as articulated in the Armenia Development Strategy 2025, prioritizes modernizing public administration and governance, and development of money and capital markets.[5] The strategic directions developed by the Central Bank of Armenia (CBA) postulate efforts to develop money and capital markets and to introduce good international practices to promote diversification and growth.[6] CBA and the Ministry of Finance (MOF) have initiated several reforms covering legal, regulatory and institutional development in what constitutes a wide reform program. The government will implement an issuance program to promote liquid benchmark securities to establish a reliable domestic yield curve. Complementary reforms will strengthen the primary dealer system to establish a market making function to further increase trading activity and liquidity.

C. Impact and Outcome

12. The program impact will be increased fiscal sustainability and resilience in the financial sector of Armenia by 2020. The outcome will be increased depth of financial markets in Armenia as measured by ratio of outstanding debt securities of government to GDP and turnover volume in government securities. The outputs will be (i) public debt and fiscal risk management strengthened, (ii) government securities market and money-market infrastructure deepened, and (iii) base of instruments and investors broadened.

D. Outputs

13. **Output 1: Strengthen Public Debt and Fiscal Risk Management to Enhance Fiscal Discipline and Transparency.** Armenia's debt management functions can meet the government's financing requirements, but its public debt management practices need improvement along certain dimensions. The limited capacity of the Public Debt Management Department (PDMD), particularly in its middle-office functions, exposes the government to risks which if eventuated could mean a loss of market confidence in government debt and thus higher interest costs. This program will strengthen the government's debt management practices by

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[5] Government of Armenia. 2014. *Armenia Development Strategy for 2014–2025*. Yerevan.
[6] CBA. 2014. *Strategy of the Central Bank of Armenia 2015-2017.* Yerevan.

strengthening the Public Debt Law, introducing more formality in PDMD's internal procedures and operations, being more transparent on the government's debt portfolio and the government's intentions over the medium term, and introducing an operational risk management framework. The government is seeking to promote and expand PPPs for the provision of public services and infrastructure. However, PPPs require a lot of preparatory work, a broad range of skills during negotiations, and careful oversight during implementation. This program will support the government in developing a PPP policy, and building the necessary capacities within government to promote, manage and execute PPPs. In general, PPPs incur contingent liabilities and this program will strengthen and expand the government's management of fiscal risks. This will lead to efficient and adequately resourced management of operational and fiscal risk exposures which support stable and predictable fiscal outcomes.

14. **Output 2: Deepen Government Securities Market and Money Market Infrastructure to Finance Budget and Develop Financial Markets in AMD.** Subprogram 1 set in motion two mutually reinforcing processes: the establishment of a market-development friendly public debt issuance program and management; and the development of the institutional and technological infrastructure for money-markets development. Subprogram 1 assists the government to gradually transition away from foreign-currency risk in public debt issuance by factoring in that objective in the medium- term debt strategy and domestic debt issuance plans. It also sets the stage for the implementation of a debt issuance program and practices that are more conducive to improving price discovery and liquidity in key tenors of the government debt yield curve. Under Subprogram 1, MOF started to develop benchmark bond issues through high issue limits and the use of switch operations. Subprogram 1 also supported money market development with the initiation of a Regular Treasury Bill Program (RTBP) to balance MOF funding and market development requirements. A more effective primary dealers system has been established with market-making responsibilities and other efforts to also promote price-discovery and liquidity in government securities markets. The access to public debt issuance for retail investors has been enhanced using mobile technology.

15. A large reform effort to establish the legal framework for key money-market infrastructure and instruments for secured interbank transactions has been accomplished under Subprogram 1. With further work on secondary regulation and IT systems (Subprogram 2 will help the introduction of a standard repo documentation — based on the General Masters Repos Agreement to allow for an increased diversity of trading strategies — and the design and implementation of an electronic settlement system for repos and the derivatives repository), this will fundamentally improve the efficiency and "secured" nature of repo instruments and promote the active and efficient use of T-bills and repos for cash and liquidity management. Reforms under this output: (i) will increase trading volumes and price liquidity in government securities, and support substitution of foreign currency risk exposures for domestic interest rate risk exposures by public and corporate borrowers and lenders, leading to financial deepening in AMD and reduced dollarization; (ii) represent key prerequisites in developing a reliable risk-free yield curve upon which corporate debt markets can function. Under Subprogram 1, an institutional coordination mechanism was established to develop, under Subprogram 2, a capital markets development strategy.

16. **Output 3. Base of capital markets instruments and investors broadened and corporate transparency enhanced to increase mobilization of private investment**. The third output will focus on strengthening the legal and regulatory framework and corporate governance practices so new instruments, investors and issuers participate in capital markets. Changes to the legal framework for securities have helped reduce transaction costs and improve transparency on prices, risks and other key factors to protect investors. Under Subprogram 1 the CBA submitted

to the National Assembly changes to the Mortgage Lending law and the Covered Mortgage Bonds Law. Under Subprogram 2 these changes will be approved by the National Assembly and the CBA will propose amendments to the Securitization Law to clarify the nature and attributes of new investment instruments. To increase resource mobilization under private equity funds, subprogram 1 supported policy changes to facilitate foreign investors in local currency in Armenia operate under the protection of American law. Under Subprogram 2, the government will introduce the concept of a shareholder's agreement to increase transparency and shareholders' protection. Weak corporate governance and lack of complete and reliable financial information on domestic companies dissuades investors and does not ensure that savings are effectively channeled to those companies that need capital to grow and generate jobs. To strengthen accounting and auditing practices, under Subprogram 1 MOF introduced reforms to progressively increase accounting standards and external audit requirements in the Armenian private sector. Under Subprogram 2, these reforms will be further advanced, including the establishment of a Public Oversight Board with regulatory and oversight functions on audit. These measures will broaden the investor base, pave the way for new types of securities such as covered bonds to be introduced and open new investment opportunities for local and foreign investors in private equity and infrastructure.

E. Investment and Financing Plans

17. Tepid economic growth, deflation and expansionary fiscal policy undermined the government budget in 2016, causing the budget deficit to widen to 5.5% of GDP from 4.8% in 2015. Higher borrowing for infrastructure development and to cover the budget deficit raised the ratio of public debt to 56.6% of GDP at the end of 2016 from 48.7% a year earlier. External public debt increased to 45.8% of GDP from 41.4% in 2015, while domestic debt rose to 10.8% from 7.3% in 2016. To reduce debt-related vulnerabilities and contain fiscal risks the Government envisages significant fiscal consolidation in 2017. With public debt exceeding 50% of GDP and in line with Armenia's fiscal rule, the Government aims to reduce the budget deficit from 5.5% in 2016 to 2.8% in 2017, mainly through revenue mobilization and cuts in capital spending. Over the medium term, the budget deficit is expected to narrow to 2.7% of GDP in 2018 and 2.4% of GDP in 2019.

18. The government has requested a policy-based loan equivalent to $90 million from ADB's ordinary capital resources (OCR). The loan amount reflects the government's financing needs, and strength and development impact of the proposed policy reforms. The OCR loan will have a 15-year maturity including a 3-year grace period, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based loan lending facility, a commitment charge of 0.15% per year, and such other terms and conditions as will be set forth in the OCR loan agreement. The government's financing needs in 2017 and 2018 are projected to be $561.7 million and $636.1 million, respectively, as shown in table 1. The financing gap (i.e. the difference between financing needs, excluding domestic debt, and available financing), is expected to narrow from 1.7% of GDP in 2017 to 1.2% in 2018 and 1.4% in 2019.

19. The program loan will be released in two subprograms. The first sub-program for $40 million is likely to be released in the fourth quarter of 2017; the second sub-program for $50 million is expected to be released in the third quarter of 2018, upon satisfactory completion of the policy actions and approval of the loan for sub-program 2. The loan size is justified considering the government's development expenditure and financing needs (Table 1).

Table 1: Armenia State Budget Financing Gap for 2017–2019 (Projected)

	Item	Amount ($ million) 2017	Amount ($ million) 2018	Amount ($ million) 2019	% GDP (2017)	% GDP (2018)	% GDP (2019)
1.	Revenues and grants[a]	2,545.4	2,847.3	3,133.6	22.4	23.4	23.5
2.	Expenditure	2,861.2	3,177.3	3,453.8	25.2	26.1	25.9
3.	Overall fiscal balance (=1-2)	(315.8)	(330.0)	(320.2)	(2.8)	(2.7)	(2.4)
4.	Debt Repayment[b]	586.5	678.2	723.5	5.2	5.6	5.4
5.	Financing needs (excluding domestic debt)	561.7	636.1	667.0	4.9	5.2	5.0
6.	Financing	367.1	487.6	478.2	3.2	4.0	3.6
7.	Financing Gap (=5-6)	164.6	148.5	188.9	1.7	1.2	1.4

Notes: GDP for 2017 = $11,370.3 million; 2018 = $12,171.0 million and 2019 = $13,339.6 million. $1 = AMD 475.4

[a] Excluding proposed ADB loan.

[b] Includes external and domestic debt repayment of $245.9 million and $340.6 million respectively in 2017; $306.1 million and $372.1 million respectively in 2018, and $346.9 million and $ 376.6 million respectively in 2019.

Sources: 2017 State Budget; Medium-term Expenditure Framework, 2018-2020.

F. Implementation Arrangements

20. MOF will be the executing agency. CBA and MOF will be the implementing agencies. MOF has been the executing agency in prior program loans.

G. Follow-up Actions

21. The policy matrix was agreed in the wrap meeting with the Vice Prime Minister on July 6, 2017. The following subprogram 1 policy actions which were still being discussed at the technical level were resolved with the Vice Prime Minister’s approval: (i) Action 6 on division of responsibilities for managing various categories of fiscal risks. It was decided that ADB will provide immediate technical guidance to assist the government in accomplishing this; (ii) Actions 7 and 8 on PPP policy and resourcing the PPP unit. Due to the expectation that drafting and approval of the policy may be completed after the August deadline, it was decided to make these actions become loan effectiveness conditions in case they are not met in time. The government is requested to sign the MOU by July 19, 2017 to enable the ADB processing team to timely complete the preparation of the program as presented in the schedule below. The government is also requested to collect all the compliance documentation as evidence for completion of subprogram 1 policy actions and start sharing with ADB. The mission will apprise the program counsel of the latest discussions and the process of collecting compliance documents to seek her advice.

H. Processing Schedule

22. The indicative processing schedule is in Table 1.

Table 1: Proposed Processing Schedule (2017)

Milestones	Expected Completion Date
Management review meeting	August
Loan negotiations	September
Board consideration	October
Loan Signing	November

Source: ADB Staff.

I. Acknowledgements

23. The mission would like to express its gratitude to the government for support and cooperation extended during the mission and looks forward to continue working closely with the government.

Vardan Aramyan	Tariq Niazi
Minister of Finance	Principal Public Management Specialist
Republic of Armenia	Central and West Asia Department
	Asian Development Bank

Armenia, 12 July 2017

List of Persons Met

Government of Armenia

1. Mr. Vache Gabrielyan – Vice Prime Minister, Minister of International Economic Integration and Reforms

Ministry of Finance

2. Mr. Armen Hayrapetyan – Deputy Minister of Finance
3. Mr. Karen Gasparyan – Deputy Chief of Staff
4. Mr. Arshaluys Margaryan – Head of Public Debt Management Department
5. Mr. Arayik Yesayan – Head of Obligations Management to State Budget Department
6. Mr. Argam Aramyan – Head of International Cooperation Department
7. Mr. Ashot Vardanyan – Head of Information Technologies Infrastructure Installment, and Development Department
8. Mr. Artur Hambardzumyan – Head of Strategy and Risk Management Division, Public Debt Management Department
9. Mr. Artak Martuyan – Head of Accounting and Service Division – Deputy Head of Public Debt Management Department
10. Mr. Hrayr Yesayan, Head of Financial Planning of Current Budget Expenditures on Agriculture, Food Safety, Nature Protection and Water Economy Sectors Division - Deputy Head of Budget Expenditures Financial Programming Department
11. Mr. Loris Muradyan – Head of Fiscal Risks Assessment Division
12. Ms. Larisa Harutyunyan – Head of Foreign Countries and International Organizations Division Cooperation Division, International Cooperation Department

Ministry of Economic Development and Investments

13. Mr. Hovhannes Azizyan – Deputy Minister of Economic Development and Investments
14. Mr. Vahagn Lalayan – Head of Investment Attraction and Coordination Department
15. Mr. Aram Vardanyan – Head of Investment Programs Division

Central Bank of Armenia

16. Mr. Nerses Yeritsyan – Deputy Governor of the Central Bank of Armenia
17. Mr. Arman Potikyan – Head of Financial (Markets) Department
18. Ms. Sona Baghdasaryan – Long term Projects Legal Assistance Team, Legal Department
19. Mr. Karen Hakobyan – Head of Securities Market Regulation Division

International Financial Institutions

20. Ms. Teresa Daban Sanchez – Resident Representative for Armenia, IMF
21. Mr. Vahram Janvelyan – Economist, IMF Resident Representative Office in Armenia
22. Mr. John Zohrab – PFM Regional Advisor, IMF Fiscal Affairs Department
23. Ms. Angela Sax, Associate Director - EBRD

Center for Strategic Initiatives

24. Mr. Aleksandr Khachaturyan - Executive Director of the Center for Strategic Initiatives
25. Ms. Tatevik Muradyan – Head of Investment/PPP projects

Nasdaq-OMX

26. Mr. Konstantin Saroyan - Chief Executive Officer of NASDAQ OMX Armenia
27. Mr. Karen Zakaryan-Deputy CEO

POLICY MATRIX

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
Output 1: Strengthen Public Debt and Fiscal Risk Management to enhance fiscal discipline and transparency			
Improve management of public debt	1. Ministry of Finance (MOF) strengthens the Public Debt Management Department (PDMD) by: (i) introducing procedures on (a) issuance of Eurobonds; (b) payment procedures for the external and domestic debt, and (c) mapping links between PDMD's databases, the analytical tools used, and the reporting requirements; (ii) engaging PDMD front office in the end to end external borrowing process and negotiations.	MOF decree citing PDMD procedures. PDMD procedures flow chart MOF provides a Memo to confirm compliance with.	1. MOF: (i) studies the costs and benefits of expanding PDMD's role within MOF; (ii) centralizes analysis and reporting of existing government debt within PDMD to ensure a holistic and consistent approach within the context of the medium-term debt strategy (MTDS).
			2. MOF approves a manual for contracting and negotiating external loans, and a framework for evaluating the cost-effectiveness of alternative forms of external borrowing and guarantees, i.e. the cost-at-risk analysis to enhance the MTDS process.
	2. Government approves revisions to the regulatory framework for government securities to allow	Government decree detailing revisions to regulatory	3. Government submits legislative amendments to the Parliament on the Law

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
	reopening of T-bill issuance and improve the settlement system.	framework on government securities.	on Public Debt and, if required, on the Laws on International Treaties, Treasury Systems, and Budget Systems to strengthen the role of MOF in the external borrowing process.
	3. MOF issues a decree that a Debt Sustainability Analysis will be undertaken each year and be published annually.	MOF Decree.	4. MOF publishes the 2017 annual Debt Sustainability Analysis on its website.
	4. MOF issues a Decree approving an action plan to: (i) enhance PDMD's risk management capacity by considering the staff, systems and financial resources that would be required to identify and quantify risks associated with public debt management; and (ii) provide monitoring and regular reporting on PDMD risks.	MOF decree which includes approved action plan.	5. MOF adopts a formal Operational Risk Management framework for PDMD which includes a risk matrix that (i) identifies risks and the impact of those risks on outputs and assesses financial loss and the budget impact, and (ii) provide monitoring and regular reporting on PDMD risks.
	5. MOF increases security and backup of all debt records to prevent unauthorized changes to debt records by appointing a systems administrator for DMFAS and approving rules and procedures for: (i) access to DMFAS system; (ii) monitoring system security; and (iii) regular backup arrangements.	MOF decree which includes the system administrator and approved rules and procedures related to security arrangements for DMFAS.	6. MOF approves a Business Continuity Plan (BCP) which includes establishing a secure offsite premise, and backup of records on the debt management and financial analysis system and spreadsheets with a capacity building plan.

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
Increase monitoring of fiscal risks including from PPP projects	6. MOF submits to ADB a roadmap for the division of fiscal risk management responsibilities to cover—budgetary lending, concessions, PPPs including contingent liabilities, guarantees and other; as well as the different functions of risk management (e.g. vetting, risk monitoring and reporting) to be implemented during subprogram 2. (ADB Technical Assistance).	MOF decree which includes the fiscal risk management plan.	7. MOF approves a framework for vetting, assessing and evaluating budgetary lending operations and guarantees which is to be published.
			8. MOF presents in the 2019-2021 MTEF a summary of budgetary lending operations. under the recently approved budgetary lending framework. (ADB Technical Assistance)
	7. Government approves a PPP policy (paper) that defines the policy approaches to legislative, regulatory and institutional frameworks to: (i) govern the identification, vetting, and preparation of public-private partnerships (PPPs) based on risk profiling, fiscal affordability, and financial viability; (ii) govern unsolicited proposals; (iii)	Government decree approving the PPP policy.	9. Government submits to the Parliament the draft PPP law for approval, based on the PPP Policy (paper).

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
	monitor the performance of each PPP.		
	8. The PPP Policy or a subsequent government decision to determine the resources that are required for the functions based on PPP policy (irrespective of where it will be located) to be adequately operated under the prospective framework.	Government decree approving the PPP Policy.	10. Government's designated agency implements standard methodologies including guidelines and/or manuals to cover (i) the identification, vetting, and preparation of PPPs based on risk profiling, fiscal affordability, and financial viability; (ii) the governing of unsolicited proposals; and (iii) monitoring performance of each PPP; This includes implementing value for money tests in the vetting process based on the public sector comparator, and with or without viability gap financing; and (iv) sector specific public sector comparator benchmarks.
	9. Ministry of Economic Development and Investments publish, in its website, standard information (as jointly agreed) about all past PPPs including concessions transactions.	MOEDI website information.	

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
Output 2: Deepen Government Securities Market and Money Market Infrastructure to Finance Budget and Develop Financial Markets in AMD			
Develop a medium-term capital market development strategy	10. MOF and CBA establish a working plan for the Steering Committee for Capital Markets and the recently-established Task Force for Financial Markets Development to develop a time-bound roadmap for Capital/ Financial Markets Development	MOF/CBA MOU which includes working/action plan.	11. MOF and CBA approve the time bound road map for the medium-term development of capital and financial markets in the country.
Improve public access to government retail debt	11. MOF establishes an electronic sales system for retail debt via the internet in line adopting international good practices.	Link to website.	12. A reporting framework of retail debt issuance and redemption is implemented and available on the MOF website.
Expansion in the domestic debt program to reduce foreign currency risk exposure.	12. PDMD establish a Working Group with terms of reference to; (i) investigate the costs and benefits of accelerating the transition from external debt issuance to domestic debt issuance; (ii) identify a framework for this analysis to be undertaken regularly within the MTDS framework; and (iii) investigate how the transition to domestic debt may be structured to minimize foreign exchange volatility.	MOF decree which includes composition of working group with terms of reference	13. Working Group Report is approved and adopted with an action plan which includes: (i) how the analysis should be undertaken within the MTDS framework; (ii) how the findings will be reported and published.; and (iii) PDMD, in consultation with CBA, publish an internal paper on the potential exchange rate impact and mitigation strategy when external debt is repaid and funded domestically.

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
Developing government securities market	13. MOF approves a revised framework for Primary dealers (PDs) that includes; (i) market making responsibilities with a maximum ceiling on bid-ask spreads; (ii) evaluation criteria orientated around an appointment process that reflects a PD's contribution to developing the government secondary market and (iii) recognition of the need to rotate PDs with other market participants.	MOF decree showing the revised framework. .	14. MOF implements the new governing framework for PDs.
	14. MOF: (i) increase the bond issuance amount to at least AMD200 billion; and (ii) consult investors on increasing the domestic bond auctions from 8 times a year to monthly to provide more price discovery around the yield curve and increased access to the supply of bonds and distribute the interest rate risk evenly over 12 months.	Copy of relevant public announcement.	
Improve liquidity in the Money Market	15. MOF supports further development of the short-term money market by (i) initiating amendments in the regulations to organize reopening for T-bills to consolidate the issuance to enhance liquidity: and (ii) develop and start a Regular Treasury Bill Program (RTBP). (Under a RTBP 91, 182, 273 and	Government decree with regulations. Copy of relevant public announcement detailing RTBP.	15. MOF reviews the implementation of the RTBP with maturities and volumes consistent with the feedback from the market and aligned to monetary and debt management policies and the need to develop a liquid money market.

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
	365 bills are issued in regular fixed volumes which provide investors with a certain supply of short term T-Bills in sufficient volumes to meet demand for a short term low risk liquid instrument and support the secondary market.)		
Enhance transparency and predictability			16. MOF publishes: (i) the Treasury Securities annual borrowing plan and updates on its website; and (ii) a clear policy on its bond buyback and switch operation to add predictability to its debt management for investors.
Enhance money market infrastructure and secured transactions	16. Parliament approves a new legal framework and necessary amendments to existing laws to enable the use of derivatives (ISDA agreement) and secured interbank lending based on standardized repos (using the GMRA).	Copy of the approved law.	17. CBA: (i) introduces implementing regulations and systems to establish a GMRA to enhance money market liquidity; and (ii) uses GMRA master agreement for its operations which can be varied as a template for interbank and other commercial lending within the financial markets.
	17. CBA: (i) implement regulations and develops IT framework for unified repository of derivatives and (ii) facilitate establishment of Clearstream Link for issuance of local currency bonds.	CBA decree with regulations and describing the IT framework and clearstream link.	18. NASDAQ offers bond switch auctions to facilitate consolidation of outstanding issues based on the CBA and MOF agreement and

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
			MOF issued terms of reference.
	18. CBA develops a Repo project management plan to select and implement a Triparty Repo system in Armenia covering; (i) consulting the stakeholders; defining the requirements; (ii) issue an RFI to identify the software provider options and costs; (iii) ascertain market support and conduct a cost benefit analysis of the options; and (iv) an assessment of the resources to support the project.	Copy of repo project management plan approved by CBA management.	19. CBA implements the Repo project plan and the design and resources for a new IT system solution for triparty repos with Nasdaq that is cost effective and affordable.
	19. MOF transfer auctions to the new Nasdaq OMX platform for primary auctions of government securities.	MOF approval document showing transfer has been affected.	
Cash/Liquidity management.			20. MOF; (i) reviews the source and analysis of government cash flows to improve the accuracy of its forecast projections; and (ii) develops a cash management framework using T-bills, buybacks, switches and other instruments which is coordinated with the CBA's liquidity management function.

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
Output 3: Broaden Base of Instruments and Investors and Enhance Corporate Transparency to Increase Mobilization of Private Investment			
Develop legal framework for new types of securities to broaden the investor base	20. To strengthen the legal basis of the mortgage bonds market, the CBA submits to Government: (i) a new law for Residential Mortgage Lending, to strengthen consumer protection, and (ii) amendments to the Covered Mortgage Bonds Law to enable multi issuer facilities.	Copy of the new law for Residential Mortgage Lending, and (ii) amendments to the Covered Mortgage Bonds Law submitted by CBA to government.	21. Parliament approves: (i) a new law for Residential Mortgage Lending (consumer protection); and (ii) amendments to the Covered Bonds Law.
			22. To strengthen the legal basis for asset securitization and asset-backed securities, CBA submits to the government a set of proposed amendments to the Securitization Law, to clarify the fund nature of special purpose vehicles, enable synthetic securitization, and enable the issuance of securities before a loan-book purchase.
Develop legal framework for private equity to increase the volume of resource mobilization	21. CBA makes regulatory changes to enable private equity and other investment fund vehicles to have their subscribed capital denominated in USD.	Copy of CBA regulation and/or official interpretations.	23. Government introduces modern elements of corporate law, such as the concept of shareholder’s agreement (e.g. as an amendment to the JSC Law).

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
Strengthen corporate transparency requirements and the financial information practices by encouraging the participation of institutional investors in private debt and equity markets	22. MOF submits to the Government a private sector accounting and External Audit Development Strategy Concept that establishes actions to progressively mainstream external audit requirements in the Armenian private sector.	Copy of the MOF private sector accounting and External Audit Development Strategy submitted to government.	24. Government approves amendments to the Laws on Accounting and Audit and a new proposed Law on Regulation and Public Oversight of Audit and Accounting to delegate some regulatory functions to a Public Oversight Board (POB) and the prospective Chamber of Accountants and Auditors of Armenia.
	23. MOF submits to the Government legislation regulating private sector accounting and setting requirements for companies that are subject to statutory audit based on the amount of annual turnover, the amount of assets and the average number of employees.	Copy of the MOF draft legislation regulating private sector accounting for companies that are subject to statutory audit submitted to government.	25. Parliament approves legislation including mandatory audits and MOF establishes the POB (with a functional secretariat), and initiates public outreach discussions on (i) delegation of oversight role on audit to the POB and (ii) mandatory audits and drafts sub legislations and relevant regulations to implement the new accounting and auditing legal framework.
	24. MOF submits to the Government amendments to the law on accounting and the law on auditing, and introduce a new Law on the Regulation and Public Oversight of	Copy of the MOF amendments submitted to government.	26. MOF implements a statement of objections to ensure that all relevant regulations for the implementation of the new

Policy Objectives	Policy Actions Subprogram 1 (by August 2017)	Compliance Documents	Policy Actions Subprogram 2 Indicative (by August 2018)
	Audit and Accounting to enhance the quality of corporate financial reporting factoring in the recommendations of the Private sector accounting and External Audit Development Strategy Concept.		accounting and auditing legal framework are developed in accordance with the respective law and the MOU.
	25. MOF signs a MOU with the Association of Accountants and Auditors of Armenia (AAAA) on the way forward for a new division of responsibilities in the regulation of Audit in line with international good practices.	Copy of MOU.	

AMD = Armenian Dram, CBA = Central Bank of Armenia, DMFAS = Debt Management and Financial Analysis System, GMRA = General Master Repo Agreement, ISDA = International Swaps and Derivatives Association, MOEDI = Ministry of Economic Development and Investment, MOF = Ministry of Finance, MOU = memorandum of understanding, MTDS = medium-term debt strategy, MTEF = medium-term expenditure framework, PDMD = public debt management department, PPP = public-private partnership, TA = technical assistance.