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1. SUMMARY

The economy of Armenia grew by 7,6% in 2019 and by 8,2% in the first two months of 2020. This growth was suppressed by the initial spread of the COVID-19. High level of uncertainty and the expanding pandemic forced the Armenian government to impose a lockdown and state of emergency in the country for an indefinite period. However, despite widespread coronavirus infections and an acute public health crisis, the government had to abandon the lockdown in April, gradually lifting its stringent restrictive measures. Despite this, such sectors as tourism (including catering and guest services) and international passenger transportation suffered severe losses. In recent years, these sectors of the economy were demonstrating positive dynamics and were the main source of foreign currency inflows and one of the targets for SMEs bank financing.

At the same time, the current political situation in the country is not getting easier. The implementation of Pashinyan's government plans to fight structural corruption and fundamentally reform the judicial system resulted in a political and media campaign against the new government. This has exacerbated the already difficult domestic political situation, which has a negative impact on economic, investment and business decision-making.

The country's financial system, as before, remained neutral and significantly distanced from the domestic political turbulence. Due to the COVID-19 shock, it received substantial support from the government and facilitated the implementation of 22 programs designed to provide the most affected and vulnerable people and industries with direct support. The government planned to allocate AMD 150 bn (USD 300 m) for these purposes, a third of which is direct public support and about AMD 80 bn in the implementation of economic credit programs through "deep" subsidies of credit rates.

The government also expanded the list of community subvention programs and significantly increased budget capital expenditures on

Armenian Banking Sector Metrics

	2017	2018	2019
Assets, AMD tn.	4,4	4,9	5,8
Loans, AMD tn	2,9	3,2	3,7
ROA, %	0,8	1,3	1,4
ROE, %	5,1	8,4	9,7
CAR, % (min 12%)	33,2	29,9	27,6
NPL, % to loan portfolio	8,3	9,5	8,0
CBA FX rate - AMD/USD	484,10	483,75	479,70

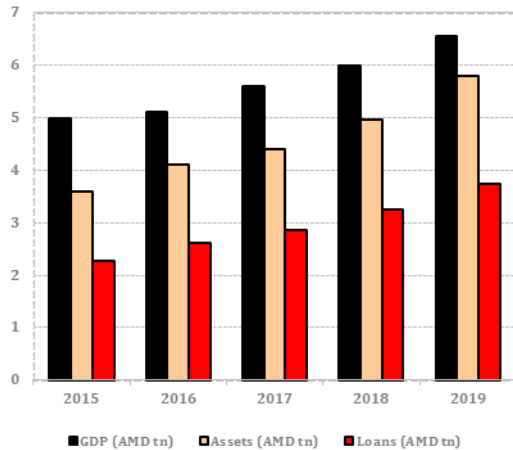
Source: AmRating based on data from CBA and the SCRA

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Graph 1: GDP, bank assets and loans, AMD tn.



Source: AmRating calculations based on data from banks of Armenia and the SCRA

construction and repair of international and inter-district roads, construction of several water reservoirs and other important infrastructure projects. Some of them are financed through loans from foreign countries and international donor organizations. Previously in 2019, the government faced a serious problem in regard to the underperformance capital expenditures (almost 70%) due to efficiency overestimation and poor design of these programs, including lack of technical and labor resources for their implementation. This considerably constrained economic activity and supported a low inflationary environment as of the end of 2019. Moreover, this also suppressed consumption, which, in turn, limited the banks' lending activity in both the corporate (9% growth) and retail (30% growth) segments. In 2020, the government is planning to utilize these saved resources for partial neutralization of the social risks related to COVID-19 and boosting economic activity in the country.

On the other hand, in order to neutralize fundamental risks under the the pandemic crisis uncertainty and preserve macroeconomic stability, on 18 May 2020, the International Monetary Fund (IMF) approved an increase in Stand-By credit for Armenia by SDR 128,8 m (about USD 175 m) to SDR 308,8 m (about 240% of Armenia's quota). These loans will help the government maintain macroeconomic activity and deal with the consequences of the current crisis.

As a result of the restrictive measures implemented to slowdown the spread of the coronavirus, by the end of April 2020 the unemployment rate had increased from almost 18% in 2019 to 21%. 70 000 jobs were cut; however, within a month 50 000 of them were re-created. Due to the partial restrictions in tourism and related services, as well as the inability of tens of thousands of seasonal workers to leave the country and, above all, to go to Russia, one should not expect a reduction in the unemployment rate in the near term. Nonetheless, the government hopes that measures to stimulate economic activity through the massive use of subvention and infrastructure projects could improve this situation.

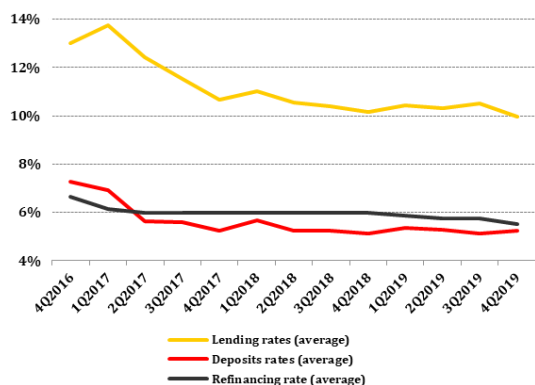
In regard to the fiscal budget, we anticipate tax revenues to fall from 22,6% to 22,3% of GDP. For this reason, as well as due to high expenditures to support the economy, the projected budget deficit may double and reach 10% of GDP. Public debt is also expected to increase from 51% to 60% of GDP, which is an average level for developing economies.

Closed borders and the economic recession in Russia, which according to the latest IMF estimates could reach 6,6%, will significantly reduce the inflow of private transfers to Armenia. This will weaken aggregate domestic demand and reduce Armenian food exports, which showed signs of recovery in 2019. In January-May

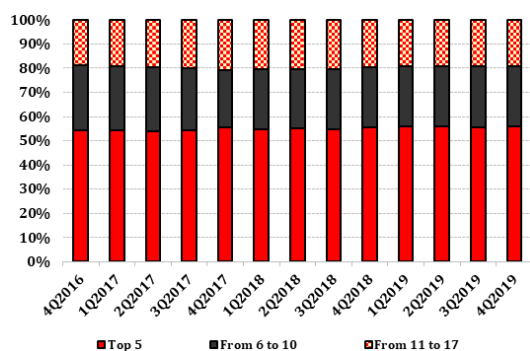
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Graph 2: Lending, deposit and refinancing rates, %


Source: AmRating calculations based on data from the CBA and banks of Armenia

Graph 3: Assets' concentration by groups of banks, %


Source: AmRating calculations based on data from banks of Armenia

2020, Armenia's foreign trade turnover decreased by 11,2%: exports fell by 8,1% y-o-y, while imports fell by 12,8% y-o-y. However, already after the lockdown, during May, the foreign trade turnover increased by 13%, mainly due to the growth of exports by 30,7%, while imports increased only by 4,3%. The slowdown of imports indicates a fall in consumption, while the increase in exports may indicate a partial recovery of the economy's industrial potential. Nevertheless, Armenia's exports to Russia have already started to decline; during 5M 2020, exports shrunk by 11% y-o-y as compared to a y-o-y growth of 0,7% in 2019.

Under the above-mentioned conditions, the Central Bank of Armenia considered it appropriate to continue with its loose monetary policy maintaining rates subdued. After a reduction of the key rate from 6% to 5,5% in 2019, in 2020 it was revised three times and was reduced to 4,5% - the last time on 16 June 2020 by 0,5% (see Graph 2).

2. INDUSTRY STRUCTURE AND PERFORMANCE

In 2019, the level of concentration of the Armenian banking system increased insignificantly: the share of assets of the five largest banks amounted to 55,9% against 55,4% in 2018 (see Graph 3). Due to uncertainty related to the expected second wave of the coronavirus outbreak in the fall of 2020, the recovery of the economy is likely to begin in 2021. The previous growth rates of more than 7% per annum are likely to be achievable starting from 2022. However, as early as in the next year, the government's measures to stimulate SMEs may offset the effects of the insufficient corporate client base of the banking system. At the same time, the same measures will raise NPLs. The reasons for it are pumping the economy with money and increased appetite for retail lending.

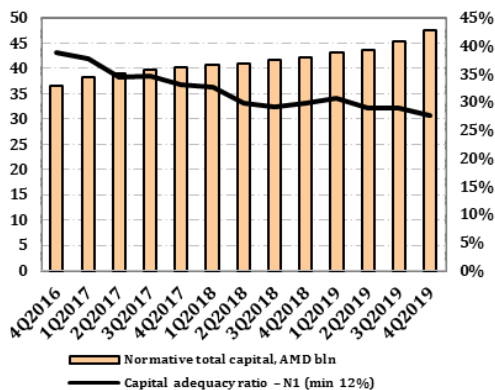
At the same time, high level of competition in the banking system, further decrease in margins and a modest level of return on capital will continue to have a downward impact on rates and may require the market to consolidate further. However, no M&A deals are expected due to the low level of profitability in the banking industry. Most likely, within the following 2-3 years the market will follow the path of "marginalization" - the presence of large capitalized leaders who can allow themselves to work on a very low or even zero margin and of small niche banks - possible future outsiders.

For this reason, in 2019, the process of reducing the share of foreign capital in the total authorized capital of commercial banks of Armenia was resumed – this share dropped from 62,8% in 2018 to 60,7% in 2019, and to 60,2% in the first quarter of 2020. The main reason is the fact that three big players quit the Armenian market: the largest European banking group Credit Agricole, a member of KfW banking group - Deutsche Investitions- und Entwicklungsgesellschaft mbH (DEG), International Finance Corporation (IFC), as well as a

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Graph 4: Capital adequacy metrics*, %


Source: AmRating calculations based on data from banks of Armenia

*Normative total capital from Jan.1, 2017 – min 30 bln AMD

significant reduction of EBRD share in the capital of one bank and full withdrawal from the capital of four.

In early 2020, EBRD decided to quit INECOBANK and sold its share (at that time already reduced from 22,7% to 12,6%) to two majority shareholders. This was preceded by the withdrawal of two more institutional investors from INECOBANK - German DEG (member of the KfW group) and IFC (part of the WB structure). These places were taken by investment funds agRIF Cooperatief U.A. (Belgium) and DWM FUNDS S.C.A.-SICAV SIF (Luxembourg) with a total share of 15,11%. In 2019, EBRD finally withdrew from Armeconombank's capital by selling the remaining 2,52% of its shares to the bank's main founder.

In total, EBRD sold its share in the capital of four banks (Byblos Bank Armenia, ARARATBANK, Armeconombank and INECOBANK) over the past five years, while simultaneously reducing its share in one - Ameriabank. EBRD has made no new successful attempts to participate in the capital of Armenian banks, although it continues to support a number of banks with insignificant credit resources as part of its donor mission.

Before the withdrawal of EBRD, the foreign strategic investor, French group Credit Agricole, decided to quit Armenia, as briefly noted above. At the end of 2018, this group sold its share in the capital of ACBA-Credit Agricole Bank, with the accompanying decrease in the nominal share of its affiliated company SJSC "Sacam International" from 12,44% to 6,48%, and subsequently - in early 2019 - to 5%. Now 95% of ACBA-Credit Agricole Bank shares belong to ACBA Federation, which replaced regional Unions of Peasant Mutual Assistance. Reasons for the exit, which was planned before the revolutionary transit of power, were not reported, but, according to analysts, they can include the loss of interest in the Armenian low-profit market and its complex segment of agricultural lending, based on technologies of farm-peasant mutual assistance.

Withdrawal of foreign shareholders may be linked to the further decline in the level of profitability and absence of a large number of efficient and solvent borrowers in the country. The level of profitability in most segments of the real sector is now estimated at 10-12%, which makes the process of bank lending ineffective and significantly reduces the margin.

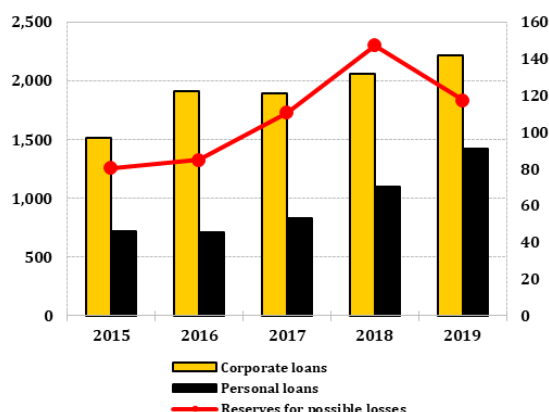
Meanwhile, it should be noted that the loss of Western investors' interest in Armenian banks and the market in general may, to some extent, be related to the geopolitical choice of the country made in 2017 in favor of the Eurasian Economic Union (EAEU) initiated by the Russian Federation.

We think that all these events can support the opinion that there are tangible disproportions leading to a decrease in the investment

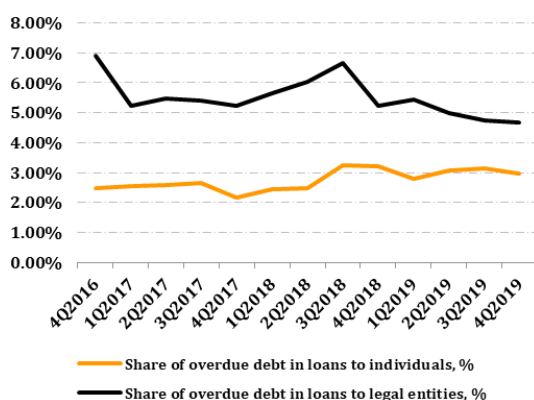
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Graph 5: Loans and reserves for possible losses, AMD bn


Source: AmRating calculations based on data from banks of Armenia

Graph 6: Share of overdue loans, %


Source: AmRating calculations based on data from banks of Armenia

attractiveness of the sector and the country as a whole. Moreover, these facts add to the negative reputation in addition to the losses incurred by the system during the consolidation period in 2015-2016. This was connected to the exit of the German ProCreditBank and Russian Gazprombank from the Armenian market: both banks suffered significant losses.

Nevertheless, the number of foreign capital holders of Armenian banks remains high: 14 out of 17 functioning banks have foreign capital registered, including subsidiaries of foreign institutional banking structures - HSBC Bank Armenia (HSBC, UK), VTB Bank (Armenia) (VTB Group, Russia), Byblos Bank Armenia (Byblos Bank S.A.L., Lebanon), Mellat Bank (Mellat, Iran).

International donor financial institutions are represented in the capital of three Armenian banks: European Bank for Reconstruction and Development (EBRD - in Ameriabank), Asian Development Bank (ADB - in Ameriabank), Rural Impulse Fund II (structure of Belgian Incofin Investment Management - Incofin IM - in Araratbank), Belgian and Luxembourg investment funds agrIF Cooperatief U.A. and DWM FUNDS S.C.A. - in Araratbank. SICAV SIF (in INECOBANK).

Foreign private capital is also widely represented by individuals, mainly by the members of the Armenian Diaspora in Russia, Ukraine, Argentina and Switzerland. The presence of some of them is structured through offshore companies.

The capital adequacy ratio (minimum level of 12%) remains solid, despite a moderate decline by 2,4p.p. from a year ago to 27,57% in 2019 (see Graph 4). This ratio started declining quarter by quarter from 2017 onwards, after the process of additional capitalization in 2015-2016 was finished. This process was attributable to the increase of the minimum level of total capital of banks to AMD 30 bn from the previous value of AMD 5 bn.

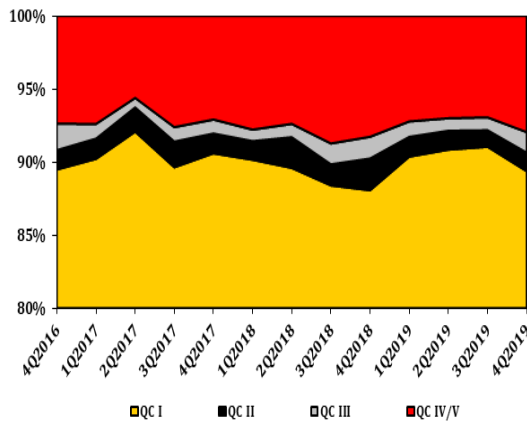
As we expected in our previous review of 2018, the slow decline of the capital adequacy ratio continued in 2019 due to deteriorating loan portfolio quality, especially for the retail loans that were refinanced in 2018 as a part of the decision to amortize fines/fees on bad retail loans. Judging by the results of the 1Q 2020, when the economy as a whole, and the banking system in particular, faced the consequences of the coronavirus pandemic, the downward trend in capital adequacy is expected to continue. However, this trend will be rather non-uniform. The top three to five banks will continue to be actively capitalized and attract substantial resources from external markets, thus securing a medium to long term future.

Meanwhile, three-month credit holidays from 13 March 2020, announced by banks at the call of the government, with a shift of deferred payments (on both interest payments and principal) on the following months (from 3 to 6 months) may cause deterioration in the

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Graph 7: Loans by Quality Category (QC)


Source: AmRating calculations based on data from banks of Armenia

quality of the loan portfolio. This, in turn, will lead to a new round of write-offs and fall of profits. The latter, according to our forecasts, will become significant at the end of 2020, as the increased debt burden accompanied by the downturn of the economy and extremely high uncertainty due to the coronavirus situation, is not a favorable environment for timely repayments.

In 2019, banks' assets accelerated their growth to 17,5% from 14% in 2018, which was accompanied by continuing growth in lending to the economy at 7,7% (see Graph 5).

But the key drivers of the upward trend in assets are retail loans and mortgage loans, as well as investments in securities (mainly government bonds). To illustrate, in the reporting year government bond investments grew a bit slower than the total loan portfolio - by 13,4% vs. 15,4%, while in 2018 this gap was much more significant. Retail lending growth slightly slowed down in 2019, to 29,9% from 31,5% in 2018. In particular, the growth of mortgage loans continued to accelerate to 39,4% from 22,5% in 2018, while consumer loans declined by 36,2% after a 36% growth in 2018. The car loans growth rate declined to 9,7% from 15,5% in 2018.

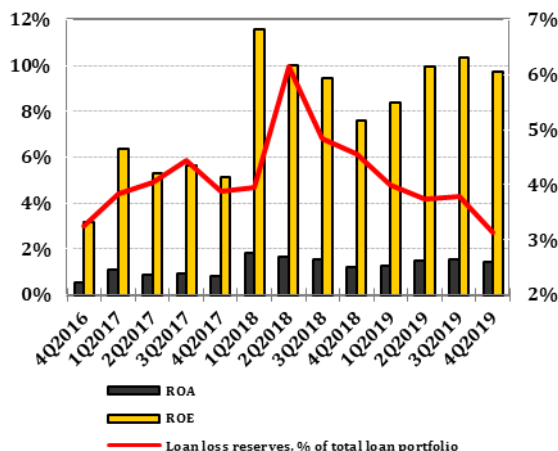
The growth of mortgage loans and the reduction of the general level of interest rates were mainly due to the intensification of special government programs to support mortgage loans refinancing by the state-owned "National Mortgage Company" and implementation of the project "Affordable Housing for Young People", the conditions of which were eased. As expected, in 2019 the retail lending market was further revived, but the quality of this growth remains problematic and fully dependent on the real income of the population. The latter will decline due to the global COVID-19 crisis, which will increase the toxicity of loan portfolios. Despite government measures to support mortgage development, we should expect a decline in this market, since real estate transactions have fallen significantly in anticipation of a housing price decline. Moreover, active mortgage lending in 2019, enhanced by state support, was assessed as a working investment instrument. A fall in real estate prices can create certain risks for the development of business.

Continued low growth of loans to legal entities is attributable to the limited capacity of the market and high indebtedness of its participants. In our opinion, the situation in the corporate lending segment remains ambiguous due to the accelerated economic growth in 2019 (7,6% compared to 5,2% a year earlier), as well as the continuing decline in the overall lending rates. This imbalance is most likely due to the low diversification of the economy, insufficient development of SMEs, low level of domestic investments and a significant decline in the profitability of production activities in recent years. Despite the increase in the industrial and agricultural sectors

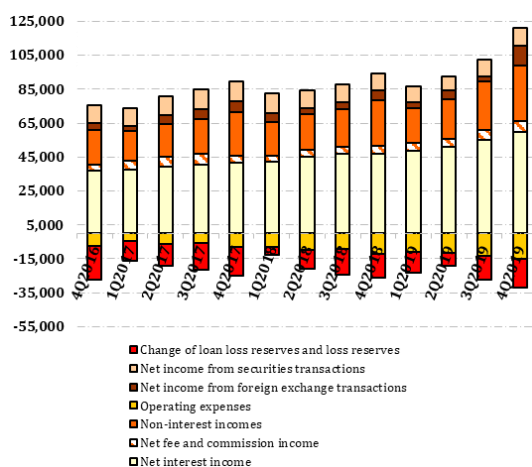
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Graph 8: Profitability metrics VS Loan loss reserves, %


Source: AmRating calculations based on data from banks of Armenia

Graph 9: Structure of financial results, AMD mln


Source: AmRating calculations based on data from banks of Armenia

growth rates (for 1Q 2020), which acted as a driver for GDP growth, banks are not in a hurry to invest in risky assets. They prefer to earn on less risky segments, increasing retail volumes, trade portfolios and receiving non-interest income. As a result, the demand for medium-term government bonds has grown strongly in recent months.

Under these conditions, in 2019, there was a decrease in lending activity to SMEs with a slowdown in growth rates from 16,3% in 2018 to 4,9%. We assume that in 2020, due to the deep government subsidization of interest rates for SMEs as a part of anti-crisis measures, the growth rate of corporate lending will not drop, but the risks of non-payment of principal will remain. Moreover, many economic agents related to such spheres as tourism, catering, and hotel business may freeze their activities altogether. The government is likely to continue to support them, but it is not known how long this state of uncertainty will last.

The quality of banks' assets remains stable. The decline in the share of overdue loans to legal entities, which started in Q4 2018 (due to refinancing), continued in 2019, dropping by 0,56 p.p. (y-o-y) to 4,66%. At the same time, no significant changes in the quality of retail loans were observed: the share of overdue loans to individuals decreased by 0,26p.p. (y-o-y) to 2,96% (see Graph 6). The share of overdue loans in the loan portfolio of banks decreased by 1,5 p.p. (y-o-y) to 8% in 2019. But the share of "poor quality" loans (categories "doubtful" and "bad quality" - IV and V, according to the CBA classification) was decreasing during three quarters and went up in 4Q, which limited the annual decline by only 0,3 percentage points to 7,9% in 2019 (see Graph 7).

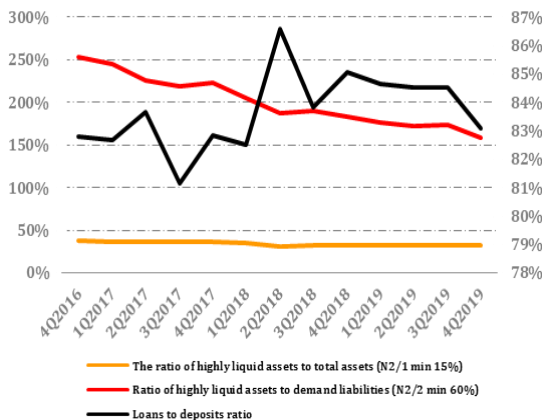
As before, we believe that the switch of the banks' focus on credit retail is worsening the quality of assets, thus, affecting the overall market performance, and we assume that this trend will continue in 2020-2021. The introduction of the debt ceiling on consumer loans in the near future may save the portfolio from greater toxicity and profits from falling.

ROA and ROE improved slightly in 2019, reaching 1,44% and 9,73%, respectively, which is the highest level since 4Q of 2014 (the last quarter before the sharp devaluation of the national currency) (see Graph 8). Such positive dynamics are mainly attributed to the refusal of the regulator to impose a rigid conservative policy of reservation and to the increase in the banks' income on commissions (see Graph 9). At the same time, a significant part of the banking sector profit is still generated by the three major players (Ameriabank, Ardshinbank and INECOBANK) – 40,3% of the total banking system profit in 2019 (versus 44,3% in 2018 and 61% in 2014). Only VTB Bank (Armenia), which has a high degree of investment in retail lending, as well as in large mining and other projects, has so far suffered significant losses.

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Graph 10: Liquidity ratios, %


Source: AmRating calculations based on data from banks of Armenia

Securing profit on a quarterly basis allowed the bank to reduce the annual loss for 2019 by 70%. We suppose that reduction of this imbalance in the distribution of profits could cut the risks to the stability of the banking system.

The liquidity position of the sector remains satisfactory despite the continued decline in the key ratios in 2019 (see Graph 10). As in the profitability indicators, we observe a high disproportionality in the distribution of liquidity levels.

The funding base was characterized by a gradual increase in the share of individual funds by 5,8 p.p. to 39,3% from 2014 to 2019, as well as by a decrease in the average level of interest rates by 2 p.p. to 5,25% for the same period. The volume of retail deposits accelerated its growth from 9% in 2018 to 15% in 2019, while corporate deposits and current accounts increased from 13% in 2018 to 32,7% in 2019. This growth was partly attributed to the activities of two private foreign companies that manage the assets of pension funds. They were established in 2017 as a part of the mandatory funded pension system and significantly expanded its client base in 2019 through government participation in the pension savings of citizens.

Another active source of funding of the asset operations was the entry of most banks into the debt market which took advantage of the Central Bank's incentive measures. In this respect, Ardshinbank was the first bank in the history of the banking system and the country to issue Eurobonds in the amount of USD 300 m with a 6,5% coupon. When these Eurobonds were issued, the demand was approaching USD 500 m. The number of investors exceeded 70: 45% from Switzerland, 30% from the USA, the rest from Germany, Great Britain and other countries.

The stable situation in the Armenian currency market has gradually lowered the traditionally high level of dollarization of the economy. Banks have been increasingly converting their assets and liabilities to AMD. Thus, the share of AMD liabilities for 2015-2019 increased from 34,8% to 42,4%, while the share of foreign currency liabilities decreased from 65,2% to 57,6%, which had a similar impact on assets - the share of AMD part increased from 44,6% to 51,2%, while the share of foreign currency part decreased from 55,4% to 46,9%. As for the assets, such situation is attributed to the dramification of the dominant item - credit investments. In their structure the share of AMD-denominated loans increased to 49,9%. This is caused by the normative restriction, according to which consumer loans (except for mortgages) may be denominated exclusively in AMD. As a result, between 2015 and 2019 the AMD share in the total loan portfolio increased from 31,5% to 49,9%, while the share of foreign currency loans decreased from 68,5% to 50,1%. It is noteworthy that such a minimal gap between the foreign currency (51%) and AMD (49%)

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part in the loan portfolio of the Armenian banking system was observed 11 years ago (in pre-crisis 2008), while the maximum gap occurred during the crisis of 2014 - 67% and 33%, respectively. At the same time, the deposit portfolio in 2008 was characterized by the maximum gap in favor of foreign currency deposits - 73% vs. 27% for AMD denominated deposits. In contrast, in the first quarter of 2020 a significant de-dollarization took place - 57% of foreign currency deposits vs. 43% denominated in AMD.

In order to avoid a "gap", the banks did the same with liabilities, 70,1% of which are funds attracted from customers (term deposits and demand deposits). In the structure of liabilities, the share of AMD funds attracted from customers increased from 20,3% to 30,3% between 2015 and 2019, while the share of foreign currency funds decreased from 43,5% to 39,8%.

The process of additional capitalization, high competition and excess liquidity pushed interest rates down. In 2015-2019 rates on loans dropped from 14,31% to 10,3% and rates on deposits - from 9,51% to 5,25%. During this period, the rates on AMD loans have decreased more significantly - from 17,68% to 11,87%, while the rates on dollar loans - from 10,94% to 8,77%. Rates on AMD deposits declined from 13,62% to 7,8% and on dollar deposits - from 5,4% to 2,71%. It is noteworthy that Armenian banks, as a rule, prefer not to work with European currency. As a result, the process of reducing the margin of active-passive transactions continues, which makes no more than 6 p.p.

3. BANK REGULATION

In the current environment the Central Bank of Armenia decided to strengthen stimulating monetary policy instruments in the medium term.

The most recent changes in key prudential norms occurred in 2020, and introduction of the new norms is scheduled for 2021. To specify, from January 2020, after a 12-year break, the fixed capital adequacy ratio was introduced with the minimum required level of 10% (against 8% in 2005-2007), and already in May it was reduced to 9%. At the same time, the total capital adequacy ratio remains at the previous minimum required level of 12%. Thus, in order to mitigate the negative impact of the uncertainty caused by the spread of COVID-19, the CBA decided to increase the share of additional capital in the structure of total capital, providing banks with an opportunity to lend to the economy through the attraction of subordinated loans and other capital instruments. This decision is a part of the CBA's long-term policy for financial stability and ensures a sufficient level of instruments to absorb the banks' potential risks and losses.

At the same time, the CBA has postponed the implementation of two new liquidity ratios established by Basel 3 - Liquidity Coverage Ratio

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(LCR) and Net Stable Funding Ratio (NSFR), so that the banks can uninterruptedly finance the real economy. This decision will come into effect on January 2021. At the same time, the general and current liquidity norms regulating the banks' liquidity risk (N2/1 - min 15% and N2/2 - min 60%) continue to be applied in the normal mode.

The introduction of three supplements to the Basel 3 capital adequacy standard has also been postponed: capital adequacy supplement, countercyclical supplement and supplement for systemically important banks. Originally, they were planned to be introduced in January 2020. After having a discussion with the banks, the CBA decided to give market participants enough time to prepare for these requirements, and to introduce these supplements in stages.

The steps taken by the CBA to activate the capital market including zeroing the norm on mandatory reserve of funds attracted by banks through bonds in national and foreign currencies (see Review dated May 7, 2018), enabled a greater number of banks to act on the corporate bond market. As a result, by 10 July 2020 there were already 12 bond-issuing banks at the Armenian Stock Exchange AMX (against 2 in 2015 and 4 in 2016). In addition, the number of currently quoted tranches already reaches 72 (against 6 in 2015 and 10 in 2016), the dominant part of which are USD-denominated (47). During 2015-2017, banks' active entry into the corporate bond market increased the volume of transactions at the exchange by 5,2 times, with a subsequent growth in 2018 by almost 3 times, what was followed by a 3% decline in 2019 - to AMD 29,6 bn. However, in January-May 2020 an increase of 23,3% (y-o-y) occurred, which will be much higher, taking into account the large tranche of Ardshinbank's Eurobonds listed since July (see below) and a number of issues of other banks in the process of listing. It is noteworthy that three banks - Ardshinbank, Ameriabank, Evokabank - managed to place part of their debt securities among foreign investors. Ardshinbank proved to be the most active bank in terms of making its securities trade internationally. It managed to place three tranches gradually increasing the issue volume: in 2014 - 3-year bonds in the amount of USD 75 m at 12% coupon (already repaid in 2017), in 2015 - 5-year bonds in the amount of USD 100 m at 12% coupon (repayment will take place in 2020), and in January 2020 - 5 year bonds in the amount of USD 300 m at 6,5% coupon.

This bond boom among the country's commercial banks was a natural result of the CBA's policy, which provided banks with reservation terms that are more comfortable than deposits (0% since October 2016), better taxation terms and maintenance of resources attracted from the open market. Later, in January 2020, the Armenian parliament adopted a draft law on introducing amendments and additions to the Tax Code on liberalization of security market and creation of attractive conditions for portfolio investments,

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development of corporate bonds market and stock market. Starting from March 2020, investment services (including market makers' services) will be exempt from VAT. At the same time, interest payments on bonds listed on the stock exchange are exempt from income tax, while non-residents are exempt from income tax. But if the issuer is a bank, such benefits apply only to bonds with a maturity of two or more years. Besides, non-residents will not be subjects to income tax on AMD government bonds and in case of issuing Eurobonds, mandatory loan payments will be exempted from income tax. Dividends on listed stocks are exempt from income tax, while non-residents are exempt from profit tax.

In December 2019, the CBA announced its intention to introduce new regulations to contain risks of growing consumer loans. The regulation is based on the analysis of the credit-income ratio unveiling whether the loans borrowed by citizens match their income. The new regulation will also address the asset-credit ratio. Earlier, in November, the CBA announced that it is considering the possibility of introducing for Armenian banks and credit companies the coefficient for calculating the maximum debt burden of individuals (in international practice - PTI, payment to income). The need to introduce this coefficient, which is the ratio of monthly loan payments to monthly income, is attributed to the intention to protect borrowers from re-lending.

The previous revisions of normative requirements by the regulator, dated 2014-2016, as well as legislative amendments and additions that took place in 2016-2018, are described in detail in the previous two issues of the banking system review (May 7, 2018 and May 28, 2019).

Reports published under IFRS 9 exist for almost all the banks. Unfortunately, the format of information disclosure under this standard does not provide a complete picture for assessing the quality of the loan portfolio, because the classification by risk groups is significantly blurred. Moreover, IFRS 9 standard does not provide for a specific industry breakdown by risk groups, which ultimately makes it impossible to assess the real quality of assets and, consequently, the resource efficiency. Moreover, even for consumer loans the blurring of risk groups makes it impossible to see the real picture with respect to their toxicity.

In 2019, after a five-year break, Armenian banks resumed attracting synthetic loans from foreign donor organizations within the framework of credit programs to stimulate investments in the real sector of the economy. This process continued in 2020 as well.

The number of state programs to subsidize interest rates on loans has increased, with the main focus on the development of the agricultural sector. 12 banks, five universal credit companies and two leasing

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companies were involved in eight such programs.

Moreover, taking into account the negative impact of the epidemiological crisis on the economy, the government decided on a number of state programs to fully subsidize interest rates on loans, even if the maximum rate is 14% (against previously approved 12%). This will affect the following state programs: agricultural loans; leasing operations in the agricultural sector; installation of anti-hail nets and drip irrigation systems; organization of intensive fruit and berry orchards with the use of advanced technologies; breeding of livestock.

Zero interest rate also applies to those individuals and legal entities that receive state subsidy on agricultural loans, regardless of the activity.

For loans aimed at the development of agricultural cooperatives, in addition to the 0% rate the government offers co-financing within the range of 10-70% depending on the purpose of the loan. In addition to the 0% rate, 30% co-financing is provided for pig and poultry production segments.

A 0% rate also applies to individual agricultural microcredits. The government has declared its willingness to subsidize foreign currency loans with a rate not exceeding 9%. The introduction of these assisting instruments will not only reduce the risk of the lender, who are mainly banks, but also develop the Armenian agriculture to a new level.

In September 2019, the insurance program for agricultural risks was launched in Armenia, so far in a pilot mode, covering six regions and with the partnership of three insurance companies (INGO Armenia, Rosgosstrakh Armenia and Sil Insurans). By May 2020, over 700 contracts have already been signed. Purchase of the insurance policy is subsidized by the state at the rate of 50-60% depending on the natural risk, and for the full coverage there is a 10% discount. At this stage, insurance will cover apricot, apple and pear orchards, vineyards, spring and autumn sowing of grain crops, and the risks covered are hail, frost and fire. The reinsurer is a major Swiss company, Swiss Re. The National Agency of Agricultural Insurers (AINA) is responsible for development of standard agricultural insurance products, conditions and regulation for the state subsidies, market research and actuarial calculations, training and professional development of damage assessors, control over partner insurance companies.

Insurance of agricultural risks will significantly increase the interest of banks in agricultural lending, thus helping the key sector of the economy to recover from the recession recorded in the last four years. In 2019, the decline in gross agricultural output slowed to 4,2% (from 7,6% in 2018) and its share in GDP declined from 14,8% to

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13%. In the first quarter of 2020 the agricultural sector even went up by 4,5% (y-o-y), while economic activity showed a 4%-growth. Under these conditions bank agricultural lending accelerated growth from 5,9% in 2018 to 10,9% in 2019, with the continuation of this trend in the first quarter of 2020 - to 14,5% (y-o-y), which is explained not only by the government subsidy programs on the more affordable terms, but also by the agricultural insurance with tangible government support.

4. OUTLOOK

The new government of Armenia, which came to power after the April Velvet Revolution of 2018, announced the implementation of an ambitious program supporting the real sector of the economy through numerous measures. Among them are the fight against corruption, ensuring equal conditions for entrepreneurship, diversification of the economy and its export potential, increase in government subsidies for tools that can increase productivity of agribusiness, reduction of the level of direct taxes through an increase in the number of indirect taxes. As noted in the last year's review, these measures require the creation of a comprehensive legislative framework and, as a result, could be implemented within 2-3 years. Despite the pandemic and difficult domestic political situation, determination of the government to continue this policy in the medium term gives hope for a gradual recovery of economic potential and structural changes in the economy.

Despite the above-mentioned disproportions and risks, which create some additional difficulties, the banking system, with a substantial capital adequacy cushion and excess liquidity, will continue to function in a stable manner in the medium term under any scenario of the current crisis. Support measures and guarantees of stability are primarily provided by the government, which supports the banks in implementing anti-crisis measures, as well as by IMF and other donor organizations.

It is possible that the departure from rigid monetary measures in favor of direct anti-crisis intervention of the state in the economy will allow to prevent a collapse in the medium term, as it was during the financial and economic crisis of 2009, when the decline in Armenia's GDP reached 15%.

Most likely, Armenia will be able to avoid economic depression in 2020 and there is no reason for stagflation. The country is likely to enter a phase of medium-term recession accompanied by a 4-5% decline in GDP, sluggish business activity and a modest increase in unemployment. This will be an inevitable period of adaptation to new conditions and preparation for a recovery by mid-2021. But that is unless there is a second more powerful wave of the coronavirus

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epidemic that will force the government to impose restrictions or even a lockdown.

It is also possible that if external demand recovers, there will be some revival of corporate lending by the 4Q due to the stimulation of state infrastructure projects and programs to support SMEs. Banks have already started to accelerate their technological development and, according to various estimates, in the near future up to 70% of their clients will have to access all the financial services and instruments remotely. This will significantly increase the share of banks' non-interest income and reduce current costs.

On the one hand, the increase in bank provisions and simultaneous growth of NPL will reduce the level of banks' profitability. But on the other hand, it will also reduce the unjustified appetite for risk in the retail segment. Banks will have to increase their trading portfolios for a while, to get involved in the implementation of the government's preferential programs to support SMEs, to master project finance and accelerate their technological development.

It is still difficult to assess the domestic political risks associated with a possible return to the past state, but the new government of Armenia, despite the "revanchist information hysteria" and unsatisfactory pace of fundamental reforms, still enjoys a high level of public confidence. Most likely, in the absence of external or other forms of force majeure, the government will be able to overcome the remaining three years of the political cycle.

The geopolitical risks associated with the unresolved Nagorno-Karabakh conflict remain unchanged and fully depend on the positions of regional and global power centers. The July hostilities on the Armenian-Azerbaijani border in Armenia's Tavush region, despite the use of artillery and tanks, were rather positional in nature and did not escalate into a major interstate conflict. They may have been the result of unfulfilled hopes for an intensification of the negotiation process, but over the past two years Armenia has significantly increased its military and military-industrial deterrent capacity to maintain the status quo and continue to work towards finding compromise solutions for a peaceful resolution of the conflict.

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ANNEX 1. RANKING OF ARMENIAN BANKS AS OF 31.12.2019

Name	Position	Total equity (USD m)	Position	Total assets (USD m)	Position	Total loans (USD m)	% of total assets	Position	Corporate loans (USD m)	% of total loans	Position	Retail loans (USD m)	% of total loans
Ameriabank	1	211,0	1	2 018,1	1	1 208,2	59,9%	2	889,4	73,6%	4	315,3	26,1%
Armbusinessbank	6	108,6	2	1 630,6	2	1 147,6	70,4%	1	955,4	83,3%	8	179,7	15,7%
Ardshinbank	2	162,3	3	1 504,6	3	1 013,1	67,3%	3	582,8	57,5%	2	383,3	37,8%
ACBA-Credit Agricole Bank	3	143,8	4	904,7	4	641,1	70,9%	6	221,5	34,6%	1	413,6	64,5%
INECOBANK	5	117,3	5	706,9	5	511,1	72,3%	4	271,1	53,0%	5	239,8	46,9%
Converse Bank	8	93,8	6	680,8	6	495,2	72,7%	5	249,8	50,4%	6	232,0	46,9%
Bank VTB (Armenia)	7	100,9	7	642,8	7	447,1	69,6%	15	89,1	19,9%	3	351,4	78,6%
ArmSwissbank	4	124,5	8	589,2	14	208,4	35,4%	12	166,6	79,9%	15	38,9	18,7%
Armeconombank	12	81,7	9	584,7	8	413,6	70,7%	7	198,9	48,1%	7	191,7	46,4%
Unibank	15	69,8	10	526,3	9	360,7	68,5%	9	190,5	52,8%	9	168,5	46,7%
ARARATBANK	14	77,9	11	463,9	10	291,4	62,8%	10	173,5	59,5%	10	117,7	40,4%
HSBC Bank Armenia*	11	86,6	12	445,2	11	284,6	63,9%	8	195,6	68,7%	13	62,9	22,1%
Artsakhbank	10	86,9	13	378,5	12	227,4	60,1%	11	171,9	75,6%	14	41,9	18,4%
EVOCABANK	17	61,7	14	344,2	13	219,9	63,9%	13	118,0	53,7%	11	100,8	45,9%
IDBank	9	92,1	15	314,3	15	189,0	60,1%	14	96,8	51,2%	12	87,8	46,5%
Byblos Bank Armenia	16	61,9	16	232,4	16	109,5	47,1%	16	44,5	40,7%	16	29,7	27,2%
Mellat Bank	13	80,4	17	134,8	17	36,5	27,1%	17	12,3	33,9%	17	13,7	37,5%
		1 761,2		12 102,0		7 804,2	64,5%		4 627,8	59,3%		2 968,9	38,0%

Source: AmRating affiliated with ArmInfo Information Company.

The ranking is based on the published balance sheet reports / annexes of banks and officially requested data.

Indicators are calculated in USD at the rate of the Central Bank of Armenia as of 31 December 2019 - AMD 479,70 / USD.

Banks are sorted by assets as of 31.12.2019.

* HSBC Bank Armenia as of December 31, 2019 - loan portfolio - USD 363,8m with the annual decline slowing down from 7,8% to 0,8%; total assets - USD 561,1m with the annual dynamics changing from 11,8% decline to 0,1% growth.

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ANNEX 1. RANKING OF ARMENIAN BANKS AS OF 31.12.2018 (end of the table)

Name	Position	Liabilities (USD m)	% of Total Assets	Position	Demand deposits of legal entities	Position	Demand deposits of individuals (USD m)	Position	Term deposits of legal entities (USD m)	Position	Term deposits of individuals (USD m)	Position	Loans from banks and other financial entities (USD m)	Position	Retained earnings/losses for 2019 (USD m)	Return on Equity (ROE)	Return on Assets (ROA)
Ameriabank	1	1 807,1	89,5%	1	543,7	1	161,0	3	174,3	2	357,7	1	399,2	1	25,3	12,6%	1,4%
Ardshinbank	3	1 342,3	89,2%	3	183,6	7	59,5	1	236,2	3	348,9	2	334,5	2	20,6	11,3%	1,4%
INECOBANK	5	589,6	83,4%	8	76,6	3	87,0	12	26,6	6	211,8	5	135,8	3	19,6	19,3%	3,0%
ArmSwissbank	9	464,7	78,9%	14	29,2	12	28,3	2	175,4	16	44,6	8	54,8	4	18,8	17,0%	3,7%
ACBA-Credit Agricole Bank	4	760,9	84,1%	9	60,8	6	62,3	6	86,6	4	296,4	3	220,1	5	15,4	11,3%	1,8%
Artsakhbank	13	291,6	77,0%	11	49,7	16	18,5	7	70,8	13	85,6	10	36,9	6	11,6	14,0%	3,4%
Converse Bank	6	587,0	86,2%	6	116,6	8	58,3	4	150,5	8	149,9	9	54,7	7	11,3	13,1%	1,8%
Armbusinessbank	2	1 521,9	93,3%	2	368,2	5	74,1	5	119,7	1	607,4	6	127,4	8	6,8	7,1%	0,5%
Armeconombank	8	503,0	86,0%	12	45,9	9	42,7	15	18,2	10	124,3	7	91,4	9	6,63	8,1%	1,1%
IDBank	15	222,2	70,7%	15	16,7	14	20,5	13	22,8	12	87,3	14	14,8	10	6,6	7,4%	2,3%
ARARATBANK	11	386,0	83,2%	10	50,5	10	38,8	16	3,9	15	75,6	4	172,6	11	5,1	7,7%	1,1%
Mellat Bank	17	54,4	40,4%	17	2,5	17	6,1			17	0,6			12	4,5	5,6%	3,3%
HSBC Bank Armenia*	12	358,6	80,5%	7	87,9	2	100,5	14	20,3	9	130,5	16	0,014	13	3,9	4,6%	0,9%
EVOCABANK	14	282,5	82,1%	13	31,5	15	20,2	9	44,9	11	122,3	12	21,2	14	3,6	5,7%	1,1%
Byblos Bank Armenia	16	170,4	73,3%	16	3,1	11	28,9	11	27,0	14	83,0	11	25,1	15	3,2	5,3%	1,5%
Unibank	10	456,5	86,7%	4	146,1	13	24,5	10	36,9	7	197,7	15	13,3	16	2,9	4,2%	0,6%
Bank VTB (Armenia)	7	541,9	84,3%	5	141,4	4	83,4	8	54,9	5	228,7	13	17,8	17	-3,2	-4,4%	-0,5%
		10 340,8	85,4%		1 954,3		914,7		1 269,2		3 152,5		1 719,5		162,6	9,7%	1,4%

Source: AmRating affiliated with ArmInfo Information Company.

The ranking is based on the published balance sheet reports / annexes of banks and officially requested data.

Indicators are calculated in USD at the rate of the Central Bank of Armenia as of 31 December 2019 – AMD 479,70 / USD.

Banks are sorted by retained earnings / loss for 2019.

*In 2019, HSBC Bank Armenia (including direct lending from HSBC Bank PLC London) had a book profit of US\$ 9,9 million with annualized growth of 2,8 times (plus level increase). Net profit for 2019 amounted to USD 4,8 million with an annualized growth rate of 2,3 times (plus level increase).

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ANNEX 2. INFORMATION ABOUT SHAREHOLDERS OF ARMENIAN BANKS AS OF 31.12.2019

Position by assets as of 31.12.19	Name	Shareholders having more than 5% of the bank's shares	Beneficial owners	Bank related groups and additional information
1	Ameriabank CJSC	Ameria Group (CY) Limited - 48,95%, EBRD - 17,76%, Asian Development Bank (ADB) - 13,94%, ESPS Holding Limited - 11,83%, Afeyan Foundation for Armenia Inc. - 7,52%	Ruben Vardanyan - Russian social entrepreneur, impact investor and philanthropist, initiator of the idea and one of the founders of the Moscow School of Management "Skolkovo", its first president её первый президент, former head and controlling shareholder of Troika Dialog IC.	
2	Armbusinessbank CJSC	Vitaliy Grigoryants - 95%, Arsen Mikayelyan - 5%	Ukrainian businessmen, brothers Valery and Vitaly Grigoryants and the associated group of the companies Arch-Limited LLC	
3	Ardshinbank CJSC	Arins group LLC - 67,966958%, Region" Finance Industrial Corporation CJSC (RU) - 29,516477%	Karen Safaryan, owner of 100% of shares of FIC "Region" (CJSC), which is the sole participant of LLC "Arins Group"	International Business Center LLC - plants: "Karkhatmeena", "Almast", "Aragats", "Araks", "Orbita", a number of construction firms, IC "Armenia Insurance"
4	ACBA-Credit Agricole Bank CJSC	SJSC "Sacam International" (the member of the Group Credit Agricole S.A.) - 5%, ACBA Ferderation CJSC - 95%		One of the largest European banking group "Credit Agricole"
5	INECOBANK CJSC	Avetis Baloyan - 38,1%, Safaryan Karen - 32,95%, EBRD - 22,7%, AGRIF Cooperatief U.A (Investment fund, Belgium) - 10,01%, Found Development World Markets S.C.A. (SICAV SIF, Luxembourg) - 5,1%	Avetis Baloyan	
6	Converse Bank CJSC	Advanced Global Investments LLc (CEO Eduardo Eurnekian) - 80,94%, HayPost Trust Management B.V. Company - 14,06%, the Armenian Apostolic Church, presented by Mother See of Holy Etchmiadzin - 5%	Eduardo Eurnekian	Erevan International Airport "Zvartnots"
7	VTB Bank Armenia CJSC	VTB Bank (Russia) - 100%		VTB
8	ArmSwissBank CJSC	HVS Holdings LTD - 87,53%, "FMTM Distribution" LTD - 12,47%	Famous Swiss entrepreneur of Armenian origin, owner of the Watch company "Franck Muller Watchland" Vardan Sirmakes, и Chrono Star International Participations Group Franck Muller S.a.r.l.	Watch company Frank Muller (Switzerland)
9	Armeconomank OJSC	Saribek Sukiasyan - 27,86%, Khachatur Sukiasyan - 16,02%, Robert Sukiasyan - 17,06%, Eduard Sukiasyan - 10,67%	The family of Sukiasyan	Enterprises of the company "Sil-Group", owned by the Sukiasyan family (Armenia)
10	Unibank OJSC	"Uniholding GG Limited" - 87,8%, Gagik Zakaryan - 6,1% and George Piskov - 6,1%	Gagik Zakaryan and George Piskov - shareholders of Uniholding GG Limited, former owners of Russian Uniastrium Bank	
11	Araratbank OJSC	One of the largest oil traders in Armenia the company Flash LLC - 72,73%, Barsegh Beglaryan (a well-known entrepreneur, the head of Flash LLC) - 22,62%, Rural Impulse Fund II (the division of the Belgian Incofin Investment Management - Incofin IM) - 4,29%	Barsegh Beglaryan, well-known entrepreneur, the head of Flash LLC	The largest Armenian gasoline trader LLC "Flash", insurance company "Flash Alliance", several agricultural enterprises in Nagorno-Karabakh, the production of alcoholic beverages
12	HSBC Bank Armenia CJSC	HSBC Europe B.V. - 70%, Wings Establishment - 30%		HSBC Group
13	Artsakhbank CJSC	Business Fund of Armenia CJSC - 51,72%, Artsakh Investment Fund - 44,99%		The bank performs some functions of the main bank of the Artsakh Republic
14	Evocabank CJSC	Prometey Cilty LLC (RU) - 94,99%, 15 individuals (residents/nonresidents) - 5,01%	Vazgen Gevorgian - controlling shareholder of the companies Zakneftegazstroy-Prometey JSC (Moscow), Prometheus City LLC (Moscow), ZNGS-Prometheus OJSC (Yerevan)	
15	IDBank CJSC	FISTOCO LTD (Cyprus) - 59,68%, CreditBank S.A.L. (Lebanon) - 40,32%	Tarek J. Khalefe (CreditBank S.A.L) and Vartan Dilanyan (FISTOCO LTD)	
16	Byblos Bank Armenia CJSC	Lebanese bank «Byblos Bank» SAL - 100%	Lebanese bank "Byblos Bank"	
17	Mellat Bank CJSC	Iranian Bank "Mellat" - 100%	Iranian Bank "Mellat"	

Source: AmRating affiliated with ArmInfo Information Company.

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