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Debt Management Performance Assessment

(DeMPA)

Armenia

November, 2013

POVERTY REDUCTION AND ECONOMIC MANAGEMENT

The DeMPA is a methodology for assessing public debt management performance through a comprehensive set of indicators spanning the full range of government debt management functions. It is adapted from the Public Expenditure and Financial Accountability (PEFA) framework. The DeMPA tool presents the 15 debt performance indicators along with a scoring methodology. The DeMPA tool is complemented by a guide that provides supplemental information for the use of the indicators.

For additional information on the World Bank's Debt Management Technical Assistance Program, including more on the DeMPA Tool, please visit our website at: http://www.worldbank.org/debt

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Abbreviations

AMD	Armenian Dram
BCP	Business Continuity Plan
CoC	Chamber of Control
CBA	Central Bank of Republic of Armenia
DBPM	Department of Budget Process Management
DeMPA	Debt Management Performance Assessment
DMFAS	Debt Management and Financial Analysis System
DPI	Debt Performance Indicator
DRI	Debt Relief International
DRP	Disaster Recovery Plan
DSA	Debt Sustainability Analysis
DSBOM	Department of RA State Budget Obligations Management
EU	European Union
FABDM	Financial Advisory and Banking–Debt Management Department
FDI	Foreign Direct Investment
GoA	Government of Armenia
ICD	International Cooperation Department
IMF	International Monetary Fund
IR	Interest Rate
MoF	Ministry of Finance
MoFA	Ministry of Foreign Affairs
MoJ	Ministry of Justice
MTDS	Medium-Term Debt Management Strategy
MTEF	Medium-Term Expenditure Framework
NA	National Assembly of RA
N/R	Not Rated
NASDAQ-OMX	Armenia Stock Exchange
ODA	Official Development Assistance
OECD	Organization of Economic Cooperation and Development
PD	Primary Dealers
PDMD	Public Debt Management Department
PFM	Public Finance Management
PRMED	Economic Policy and Debt Department
RA	Republic of Armenia
SOEs	State Owned Enterprises
TA	Technical Assistance
T-Bills	Treasury Bills
UN	United Nations
USD	US Dollar
WB	World Bank

Executive Summary

The World Bank mission team comprised of Memes/ Messrs. Lilia Razlog (mission lead, PRMED, WB), Antonio Velandia (FABDM) and Ying Li (Consultant, WB), joined by Juan Carlos Vilanova, Debt Relief International (DRI), who conducted a Government Debt Management performance Assessment (DeMPA) evaluation for Republic of Armenia[1]. At the request of the authorities, the mission took place from October 29 to November 8, 2013.

The team worked closely with the main counterparts at the Ministry of Finance (MoF), NASDAQ-OMX, Chamber of Control (CoC), as well as the officials from the other government agencies and the Central Bank of Armenia (CBA).

The mission team benefited from excellent cooperation of the Public Debt Management Department (PDMD) of the Ministry of Finance, other line departments of the MoF, CBA, Ministry of Justice, and other government and private partners.

The assessment revealed the following main highlights across the six core functions:

- **Governance** – The legal framework in Armenia is complex. It includes government debt management objectives, the purpose of government borrowing and the requirement to develop a formal government debt management strategy. While all provisions are being followed, more clarity is needed with regard to the legal requirements and procedures for commercial borrowing on behalf of the Government. Also, the formal responsibilities for the issuance of the government guarantees (in particularly external) are still not clearly defined.

- **The CBA acts as a fiscal agent of the Government**, as well as the payment agent, in accordance with a series of formal agreements and government decisions. The lending by the CBA to the Government is prohibited by the legislation. At the same time, the CBA borrows from external creditors for on-lending purposes, and all such borrowing is backed by the Government guarantees.

- **Coordination with Fiscal and Budgetary policy** – The debt service forecasts for the budget preparation are shared on a timely manner, but could benefit from more accurate estimates and sensitivity analysis. An independent debt sustainability analysis (DSA) has been undertaken on an annual basis.

- **Borrowing and Related Activities** – Domestic borrowing is conducted at market terms and is highly predictable. There are publicly available terms and procedures for auctions of T-Bills and T-Bonds. Annual external and domestic borrowing plans are prepared and implemented. Also, legal advisers support negotiations of loan agreements. However,

[1] The evaluation was limited to central government debt management. Public debt of Armenia comprises of debt of Central government and the debt of the Central Bank of Republic of Armenia.

documented procedures for external borrowing still need to be developed. Also, the existing procedures for issuance of government guarantees need to be followed in all cases.

- **Cash Flow Forecasting and Cash Balance Management** – Cash management forecasts are produced on an annual, quarterly, monthly and weekly basis by the PDMD. There is an established target on the Treasury's preferred liquidity buffer, and actions are undertaken on a monthly basis to keep the liquidity buffer at the target level.

- **Operational Risk Management** – While there is an understanding of operational risk, a formal operational risk management framework is lacking. External debt data are registered in DMFAS software, while domestic debt is recorded in an Excel file. External government guarantees issued for a number of loans contracted by the CBA are not formally recorded at the Department of Republic of Armenia (RA) State Budget Obligations Management. Domestic guarantees issued by the MoF are recorded in Excel. Business continuity and disaster recovery plans that would provide guidelines to keep the Ministry functioning in case of an emergency are also lacking.

- **Debt Recording and Reporting** – Although the existing direct debt statistics are reliable, further improvement is required for recording government guarantees.

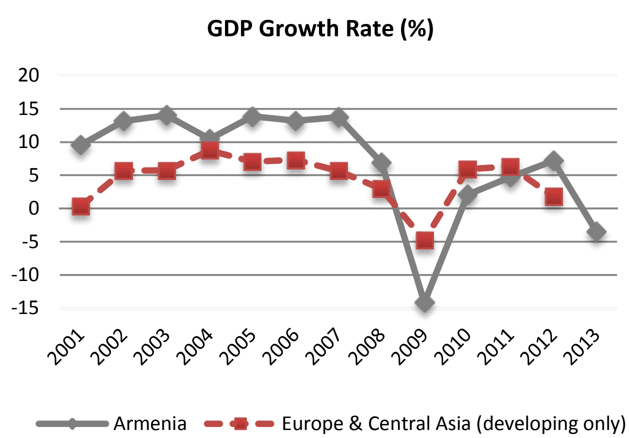
The draft report benefited from comments of two international debt management experts. The result was shared with the Ministry of Finance of Armenia, where after a careful revision, a set of comments on the report was provided.

This final report has incorporated some of those comments. Comments which did not result into revision of the report are included in the Annex 1. The Expert team provided detailed explanations on the rational for accepting and rejecting the amendments on a bilateral communication with the MoF.

Country Background

Armenia is a land-locked country, bordering with Turkey, Georgia, Azerbaijan and Iran. Around 80 percent of its terrain is covered by Rocky Mountains, with a number of non-navigable rivers and few forests. Most agricultural production is concentrated in the plain and valley areas. Around 15 percent of land area is arable. The current population is approximately three million, 98 percent of which are ethnic Armenians. Armenia has long experienced significant emigration due to persistent high unemployment and prevailing poverty (35 percent poverty rate in 2011). In recent years, annual emigration is estimated at 25,000 to 30,000 in addition to seasonal migration workers. Remittances represent an important source of foreign currency income.

The Armenian economy has experienced a profound transformation since its independence. Under Soviet central planning system, Armenia developed a modern industry that produced manufacturing goods using the raw materials and energy generated by sister republics. With the dissolution of the Soviet Union, the economy became market oriented and based more on agriculture and services.



Source: World Development Indicators (WDI) and Government data.

In 2012 the leading sectors were agriculture, trade, construction and manufacturing, representing 19.1, 12.9, 12.2 and 9.9 percent of GDP respectively. The government has adopted liberal economic policies to foster long-term growth and alleviate poverty.

Reforms have been introduced to improve investment and business environment, upgrade infrastructure and legal system. The policies to support the growth of export-led industries and small and medium-sized enterprises have been adopted. These policies have enabled Armenia to register strong growth from 2000 to 2008 (see Chart 1).

The Armenia's gross domestic product (GDP) amounted to USD 9.95 billion in 2012 which represented GDP per capita of USD 3.290. As a small economy, Armenia is sensitive to the downturn of the global and regional economies and exceedingly vulnerable due to its highly concentrated trade. The export base is narrow with mining and base metals making up more than half of total exports. These are highly sensitive to the fluctuations of international demand and commodity prices.

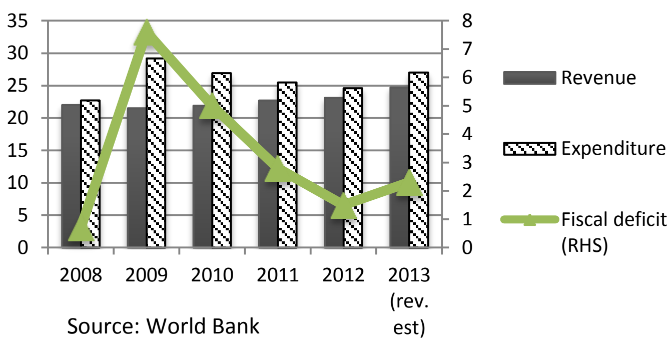
Remittances accounted for 14 percent of GDP in 2012. As manifested in 2009, Armenia was adversely affected by the slowdown of migrant workers in host countries through the sharp decline in remittances. More than 90 percent of remittances come from Russia, as well as one fifth to one fourth of imports including 80 percent of the natural gas consumed, and more than one third of the

Foreign Direct Investment (FDI) inflow[2]. Similarly 15 to 20 percent of the total exports go to Russia. The only open trade route for Armenia is through Georgia.

As a result of negative impact of the global financial crisis in 2009, the country faced a 33.3 and 25.9 percent reduction in remittance and investment inflows compared with 2008. GDP contracted by 14.1 percent in real terms, and the construction sector contracted by 41.6 percent. The poverty rate increased sharply. The public debt to GDP ratio climbed markedly from 16.4 percent to 40.4 percent. Growth has gradually picked up from 2.2 percent in 2010 to 4.7 percent in 2011 and expedited to 7.2 percent in 2012. The recovery was broad based driven by industry, services and agriculture. The construction sector remained sluggish, but was stabilizing. The preliminary statistics suggest that growth has contracted by 3.5 percent in 2013.

The inflation rate is expected to go up above the targeted range of 4±1.5 percent set forth by CBA in late 2013. This is mainly driven by the upward adjustment of utility tariffs and rising food prices. The Dram has remained stable since late 2012. The trade deficit has been persistently high at more than 20 percent of GDP. Despite the slowdown in Russia, remittance inflows remained strong in 2013 helping to narrow the current account deficit to 9 percent of GDP in 2013 from 11.2 percent in 2012.

Chart 2. Fiscal Performance (% of GDP)



Source: World Bank

The fiscal stance has tightened since 2009 as demonstrated by the declining fiscal deficit as share of GDP (Chart 2). With exception of 2009, the fiscal deficit has been lower than budgeted. The fiscal balance in 2013 is projected to be 1.7 percent of GDP compared with the budgeted 2.6 percent thanks to sound tax revenue collection and delay in capital spending.

Central Government Debt of Armenia

As of end-October 2013, the central government debt of Armenia stood at AMD 1,869.7 billion or USD 4,149.2 million, equivalent to 42 percent of GDP in 2012. The portfolio is dominated by foreign currency debt, representing 84 percent of the total debt.

[2] The FDI originated from Russia was substantially lower in 2012 than the previous years, accounting for 15 percent of the total FDI inflow.

Table 1. Central Government Debt as of end-October, 2013

	AMD (billion)	USD (million)	% of total
Total Central Government debt	1681.7	4149.2	100.0%
Domestic currency debt	270.0	666.3	16.1%
Government securities	270.0	666.3	16.1%
Foreign currency debt	1411.6	3,483.0	83.9%
Credits and loans from external sources	1,064.4	2,626.3	63.3%
Loans from domestic sources	4.1	10.0	0.2%
Eurobond	283.7	700.0	16.9%
Domestic guarantees	1.0	2.5	0.1
External guarantees*	58.4	144.1	3.5%

*All Government external guarantees are provided to the Central Bank of RA.

Source: Staff calculation based on government statistics

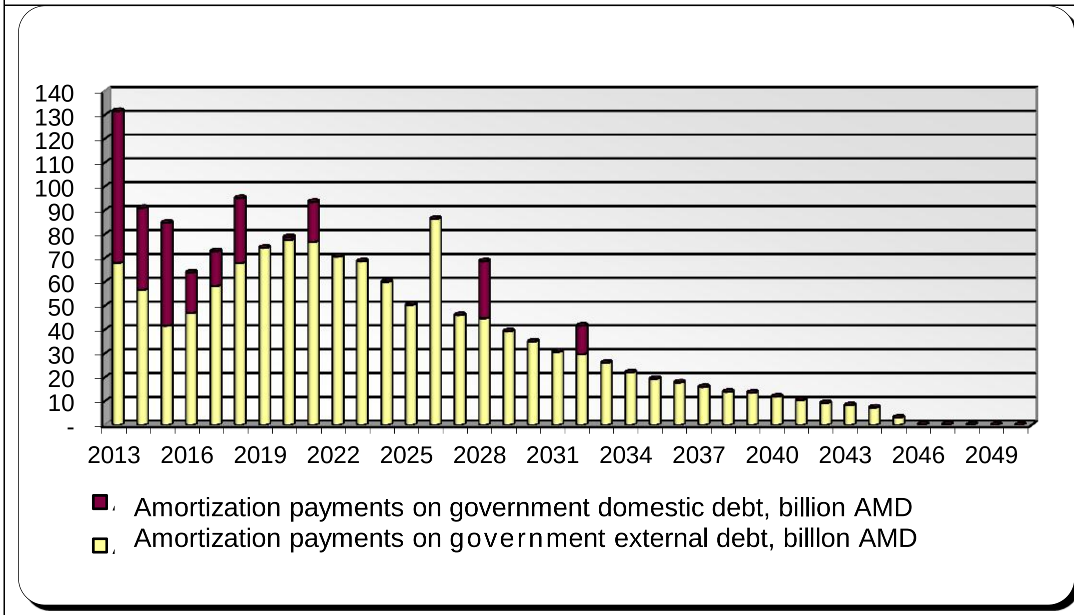
Around two thirds of the external loans are borrowed on concessional terms from multilateral lenders, including IDA, IMF, IBRD and Asian Development Bank (ADB). The rest are bilateral loans from other sovereign creditors and a small amount from foreign commercial banks. External guarantees comprise those provided by the Government to IBRD, KfW and Germany, for loans contracted by the CBA. In 2013 Armenia for the first time issued a US dollar-denominated sovereign bond for USD 700 million with a yield of 6.25 percent per annum.

As of October 30, 2013 the outstanding local currency-denominated government securities amount to AMD 270 billion. The securities consist of T-Bills with maturity up to one year, medium-term T-Notes with maturity from one to five years, and long-term T-Bonds with maturity of 5 years or longer, all with fixed interest rates. Since the end of 2012, the average life of the portfolio has been extended from 1713 days to 1848 days and the weighted average yield has increased from 13.6 percent to 14.0 percent.

The debt portfolio is exposed to significant currency risk given the high share of foreign currency debt. As of end-December 2012, 48 percent of government debt was denominated in US dollar, followed by 28.8 percent in Euro (with the disaggregation of SDR). The Government estimates that a 1 percent deviation of exchange rate of main currencies against AMD would result in an increase of the debt stock by AMD 46.1 billion, slightly more than 1 percent of GDP. Notably, during the global financial crisis the Dram depreciated more than 20 percent against the US dollar.

As shown in Chart 3, the domestic refinancing pressure is high given the sizable share of T-bills. The risk is likely to be retained given the targeted share of 15 percent of T-bills envisioned in the 2014-2016 Debt Management Strategy document. The payment of the Russian loan with the Eurobond may alleviate short-term refinancing pressures, but due to the bullet structure of the Eurobond the refinancing risk will resurface in 2020 when the principal repayment falls due.

Chart 3. Redemption Profile of Government Debt as of end-December, 2012



Source: Ministry of Finance

Armenia faces challenges as well as opportunities in public debt management. The debt portfolio has more than doubled since 2008 and is continuously growing. The composition of the portfolio is also changing. Armenia will soon graduate from IMF Poverty Reduction and Growth Trust (PGRT) and IDA on basis of per capita income criterion. The diminishing concessional financing will result in an increasing share of market- based borrowing, as well as a rise in the borrowing cost and a less favorable redemption profile. In view of the change, Armenia has made remarkable strides to access the international capital market. On domestic side, the pension reform is expected to contribute to opening up the investor base for the longer-term domestic securities.

Technical Assistance (TA) in Public Debt Management

IBRD financed the public debt management project in RA through an Institutional Development Fund (IDF) grant. The fund was granted to the MoF, Public Debt Management Department (PDMD) with the goal of strengthening public debt management and the development of the domestic debt market. The project spanned from May 2008 to November 2011. The original amount was USD 130,000 and USD 370,000 added in 2010 brought the total to USD 500,000. The grant consisted of two main components in strengthening debt management functions:

1) Capacity building in designing and implementing debt management strategy (DMS). A series of activities included reviewing the new public debt law drafted by an external consultant; the capacity building in DMS design incorporating cost-risk analysis through providing trainings and workshops as well as technical assistance from an international expert; restructuring the PDMD along functional lines; and procurement of DMFAS 6.0 for the debt recording and management system.

2) Domestic debt market development. The component was supported by training through study tours and technical assistance delivered by external consultants involving the PDMD front office and CBA. The main output from the component included improved functioning of the primary market; increased soundness of money market through an institutional framework agreement between CBA and MoF; and improved analysis of demand for government securities.

European Union (EU)

EU has provided TA to the MoF in order to help in the process of reorganization of the Public Debt Management Department and support implementation of the DMFAS system. It also plans to provide further assistance to the PDMD.

Debt Management Performance Assessment

The Debt Management Performance Assessment (DeMPA) comprises a set of 15 debt performance indicators (DPIs), which aim to encompass the complete spectrum of government debt management operations, as well as the overall environment in which these operations are conducted. While the DeMPA does not specify recommendations on reforms and/or capacity and institution building, the performance indicators do stipulate a minimum level that should be met. Consequently, if the assessment shows that the minimum requirements are not met, this clearly indicates an area requiring attention and priority for reform.

The DeMPA focuses on central government debt management activities and closely-related functions, such as the issuance of loan guarantees, on-lending, cash flow forecasting, and cash balance management. Thus, the DeMPA does not assess the ability to manage the wider public debt portfolio, including implicit contingent liabilities (such as liabilities of the pension system) or the debt of state owned enterprises (SOEs), if these are not guaranteed by the central government.

Each DPI has one or more dimensions linked to the subject of the DPI, and each dimension is assessed separately. The scoring methodology assesses each dimension and assigns a score of either “A”, “B”, or “C” based on the criteria listed. The evaluation starts by checking whether the minimum requirement for that dimension has been met, corresponding to a score of “C”. Meeting the minimum requirements is the necessary condition for effective performance under the dimension being assessed. If the minimum requirements set out in “C” are not met, then a score of “D” is assigned. In the cases where a dimension cannot be assessed, a score of “N/R” (not rated or assessed) is assigned. The “A” score reflects sound practice for that particular dimension of the indicator. The “B” score is an intermediate score, falling between the minimum requirements and sound practices.

The performance assessment in this report is based on the Debt Management Performance Assessment (DeMPA) Tool, December 2009, World Bank.

Summary of Performance Assessment

Performance Indicator		Score
Governance and Strategy Development		
DPI-1	1. Legal Framework	D
DPI-2	1. Managerial Structure: Borrowing and Debt-Related Transactions	B
	2. Managerial Structure: Loan Guarantees	D
DPI-3	1. Debt Management Strategy: Quality of Content	C
	2. Debt Management Strategy: Decision-Making Process	A
DPI-4	1. Evaluation of Debt Management Operations	C
DPI-5	1. Audit: Frequency	C
	1. Audit: Appropriate Response	C
Coordination with Macroeconomic Policies		
DPI-6	1. Fiscal Policy: Provision and Quality of Debt-Service Forecasts	D
	2. Fiscal Policy: Availability and Quality of Information on Key Macro	A
DPI-7	1. Monetary Policy: Clarity of Separation between DeM and Monetary Policy	B
	2. Monetary Policy: Regularity of Information Sharing	A
	3. Monetary Policy: Limited Access to Central Bank Financing	A
Borrowing and Related Financing Activities		
DPI-8	1. Domestic Borrowing: Market-Based Mechanisms and Preparation of a Borrowing Plan	A
	2. Domestic Borrowing: Availability and Quality of Documented Procedures	A
DPI-9	1. External Borrowing: Borrowing Plan and Assessment of Costs and Terms	D
	2. External Borrowing: Availability of Documented Procedures	D
	3. External Borrowing: Involvement of Legal Advisers	A
DPI-10	1. Loan Guarantees: Availability and Quality of Documented Policies and Procedures	D
	2. On-lending: Availability and Quality of Documented Policies and Procedures	C
	3. Derivatives: Availability and Quality of Documented Policies and Procedures	N/R
Cash Flow Forecasting and Cash Balance Management		
DPI-11	1. Effective Cash Flow Forecasting	C
	2. Effective Cash Balance Management	B
Operational Risk Management		
DPI-12	1. Debt Administration: Availability and Quality of Documented Procedures for Debt Service	D
	2. Debt Administration: Availability and Quality of Documented Procedures for Data	D
	3. Data Security: Availability and Quality of Documented Procedures for Data Recording and System and Access Control	D
	4. Data Security: Frequency of Back-Ups and Security of Storage	D
DPI-13	1. Segregation of Duties	D
	2. Staff Capacity and Human Resource Management	C
	3. Operational Risk Management, Business Continuity, and Disaster Recovery	D
Debt Records and Reporting		
DPI-14	1. Debt Records: Completeness and Timeliness	D
	2. Debt Records: Registry System	C
DPI-15	1. Central Government Debt Data: Statutory and Mandatory Reporting	D
	2. Public Sector Debt Data: Statutory and Mandatory Reporting Requirements	N/R
	3. Debt Statistical Bulletin: Quality and Timeliness	D

Performance Indicator Assessment

Governance and Strategy Development

DPI-1 Legal Framework

Dimension	Score
1. The existence, coverage and content of the legal framework.	D

Legal provisions regulating borrowing on behalf of the Government of the Republic of Armenia (RA) are scattered among several legal and regulatory documents.

The Constitution of Armenia, adopted on July 5, 1995, provides the mandate to conclude international agreements to the President of the country (art.55, 7), who is also required to recommend it for ratification to the National Assembly (art.81). The role of the Government, among others, includes implementation of unified policies in the area of loans and credits (art.89).

Further details of the government authority to enter into international agreements are provided in the International Agreements Law[3]. Such legal provisions are applicable for external borrowing by the RA and the Government of RA from multilateral and bilateral creditors. According to article 16, the power to negotiate and sign international agreements is given to the President of the RA, the Prime Minister and the Minister of Foreign Affairs without special authorization, while other government representatives require special authorization given by the President[4] (for interstate agreements) or the Prime Minister[5] (for inter-government agreements). Inter-agencies agreements classified as international agreements might be signed by the head of government bodies and agencies. However, the borrowing authority for external commercial loans or other types of commercial borrowing of the government which are not classified as international or inter-agency agreements is not regulated by this Law.

The Ministry of Justice (MoJ) and the MoF are requested to provide their formal opinion to the Ministry of Foreign Affairs (MoFA) on the drafts of international and interstate borrowing agreements prior to proceeding with the formal negotiations. After the negotiations are completed, MoFA requires the opinion of relevant line ministries, including mandatory opinions by the MoJ and MoF prior to submitting the final package to the President's Office for completion of the formal procedures required by the legislation (art.11). The mission was assured that such requirements are followed as envisaged by the law.

The Public Debt Law[6] (PDL) defines the RA public debt as the Government debt and the debt of the Central Bank of RA. According to the law, both Government and CBA[7] are entitled to acquire debt and issue guarantees.

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[3] Law of February 22, 2007

[4] The President is signing agreements on behalf of RA.

[5] The Prime Minister is signing agreements on behalf of the Government of RA.

[6] Public debt law was approved in May 2008 and amended in January 2009.

The borrowing authority on the side of the Government of RA is given to "…the Government, state bodies and administrative agencies… » (art.5). The law also envisages that the issuance of domestic debt (art.17) as well as overall government debt managements is delegated to the *Authorized Body*[8], Currently this role belongs to the MoF, as indicated in the MoF Charter, approved by the Government of the RA.

The Government of the RA also has the right to issue domestic and external guarantees (budget guarantees) and the procedures of issuance of such guarantees have to be defined by the Government.[9]

The PDL also includes clearly defined purposes of the public debt (including both government and CBA), as well as main objectives for the management of the government debt. The provisions of art.12 also require the development of the DeM strategy. However the PDL does not require annual reporting to the National Assembly, although de facto such reports are prepared on an annual basis and are publicly available. The external audit of DeM activities is also not mandatory, although the Chamber of Control (supreme entity for external audit) has the right to conduct such audit based on the legal provisions of the Law on Chamber of Control.

Other elements of the legal framework regulating government debt management are provided in the Budget System Law (BSL), Treasury System Law (TSL) and Annual budget laws.

The Budget System Law, adopted on June 24, 1997, clarifies that the MoF is responsible to carry out the management of the government debt. It also requires a formal registration of the contracts which entail state and local government liabilities at the MoF (art 15). However, not all the legal provisions of this Law are currently fulfilled (see DPI-10).

The Treasury System Law, adopted on July 27, 2001, clearly authorizes the MoF Treasury to service the government debt as stipulated under the Annual State Budget Laws and corresponding agreements (art.19, 20, 21).

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[7] The mission was informed that CBA is actively involved in the borrowing transactions from multilateral agencies for on-lending the resources through the local commercial banks. The scope of borrowing seems to be quite similar to the scope of the central government borrowing and is not limited to the support of Balance of Payments and/or reserve replenishment.

[8] It is defined as a central body of executive power of the RA which is responsible for developing and implementing the RA Government policy in the area of public finance management.

[9] Art.23 p.8 of the Law also specifies that external guarantees provided by the Government to/for the Central Bank shall be accounted for as debt of the Central Bank. The mission did not come across any such guarantees. Instead, the mission identified external government guarantees to the bilateral and multilateral lenders for the loans borrowed by the CBA.

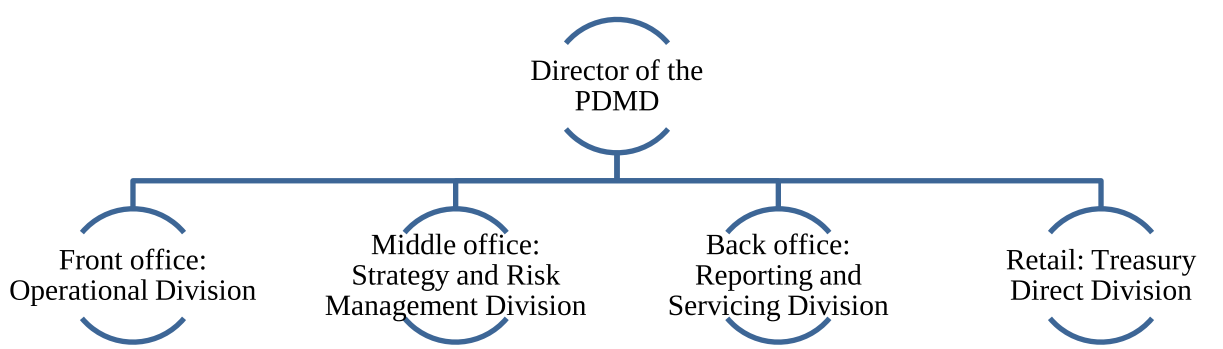
This indicator does not comply with the minimum requirements for efficient debt management – score D – as the legal framework lacks clear authorization to undertake external borrowing from commercial lenders[10]. A recent example of such borrowing is the Eurobond issued in September, where special enquiry was requested from MoJ to clarify the legal provisions authorizing this operation. Currently, the Legal Department of MoF is preparing a draft regulation to regulate such types of government borrowing.

DPI-2 Managerial Structure

Dimension	Score
1. The managerial structure for central government borrowings and debt-related transactions.	B
2. The managerial structure for preparation and issuance of central government loan guarantees.	D

The government borrowing, issuance of state guarantees, cash management and other debt management transactions are divided among several entities within the MoF of RA.

The Public Debt Management Department (PDMD), reorganized along the front, middle and back office functions in early 2012, is responsible for the management of the central government debt, including issuance of domestic debt, formulation and implementation of the DMS, government debt service, reporting of public debt, managing the retail debt program, and preparing cash flow forecasts and cash management In accordance with an agency agreement, the CBA administers the auctions for the MoF, with the MoF deciding on cut-off rates and allocation. One representative of the PDMD is always present at the CBA during the auctions.



The PDMD responsibilities are defined in its charter, approved by the Minister of Finance. The PDMD consist of 20 staff and is divided in four divisions, as listed above.

[10] Examples of commercial borrowings by the Government of RA include a loan from a Belgium Bank, loans from KFW, and the Eurobond issuance.

Although formally there is separation of front, middle and back office functions, actual transfer of responsibilities is yet to be completed.

In addition, some front office functions are partially executed by the International Cooperation Department (ICD) of the MoF, which is responsible for providing the consolidated opinion for borrowing from multilateral and bilateral external creditors on behalf of the MoF, in consultation with other relevant departments (including PDMD). This department is also involved in the dialog with international partners for exploring new sources of budget funding.

Also, the Department of RA State Budget Obligations Management (DSBOM) is formally responsible for all functions related to preparation, issuance and monitoring of Government state guarantees and on-lending. The Department consists of 10 staff in two divisions: Loan and guarantees division and Promissory notes and grants division. In practice, this department is responsible for preparation and implementation of internal procedures related to issuance of domestic guarantees, while in case of issuance of external guarantees to the international creditors the involvement of the department was not always required11. It is also in charge of preparation and processing of the budget lending transactions and on-lending to local beneficiaries, the majority of which are SOEs.

Dimension 1: To conclude, the MoF has several departments fulfilling debt management tasks. The borrowing and debt related transactions are steered by a formal DeM strategy developed by the PDMD on an annual basis. The strategy is implemented without the undue political interference, so the score "B" is assigned. For a higher score, all debt management functions have to be implemented by one single entity.

Dimension 2: Although the responsibility for preparing and managing loan guarantees is formally assigned to the Department of RA State Budget Obligations Management (DSBOM), they were not always involved of preparation of such guarantees. Thus, the minimum requirements for this dimension are not met. The score is "D".

DPI-3 Debt Management Strategy

Dimension	Score
1. Quality of the debt strategy document.	C
2. The decision making process, updating, and publication of the DeM strategy.	A

The legal framework in Armenia envisages the production of a three-year strategic plan for debt management, including target indicators of the Government debt and assessments of possible risks[12], to be included in the Medium-Term Expenditure Framework.

The most recent strategy was approved in July 2013 and covers the period 2014-2016[13]. The document was drafted by the Middle Office in PDMD with inputs from the Macroeconomic

[11] Such external guarantees were issued mainly for the external creditors which have provided loans to the CBA for purposes outside of the monetary policy implementation (see DPI 10).

[12] See Law on State Debt, approved 26 May 2008, article 12.

Department and then submitted for consideration to the Chief Treasurer and the Minister of Finance. The latter sent it for comments to the CBA, after which the strategy was submitted for the approval of Cabinet. The strategy document is uploaded in the website immediately after approval[14]. The strategy is revised and updated annually but is not being monitored in the monthly bulletins.

The current strategy contains a detailed background that summarizes the results of debt sustainability analysis; describes the developments of 2011-2013[15]; details the main objectives of the debt management strategy; and presents the expected composition of stocks and flows for the horizon of analysis.

In a nutshell, the strategy seeks to increase the share of local currency debt to reduce external vulnerability and support market development objectives[16]; and to diversify funding sources by potential borrowing from the international capital markets.

The risk analysis is presented in a series of tables projecting various indicators for interest rate and refinancing risk[17] and complemented by sensitivity analysis to calculate the impact of an increase in interest rates[18]. Similarly, exchange rate risks are computed and analyzed by projecting debt servicing flows and monitoring the ratios to CBA international reserves[19], and computing the impact of a change in the exchange rates on the budget[20]. Finally the last section presents the composition of stocks and flows for the horizon of analysis.

Dimension 1: The quality of the three-year DeM strategy document is scored with a C because it covers more than 90 percent of the central Government debt, expresses guidelines in terms of selected risk indicators, and includes the minimum target of the grant element for external loans as well as measures for market development. A higher score is not granted because the analysis of foreign currency risk is incomplete[21], the projections of Average Time to Maturity (ATM) and

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[13] "Public Debt Management 2014-2016 Strategic Plan" Annex to the Government Decree No. 740-N, July 4, 2013.

[14] The draft document was completed in January, officially sent to CBA in May and approved by the Cabinet in July, 2013.

[15] See content in DPI-4.

[16] Average Time to Maturity (ATM) should stay within 8-11 years, local currency (LX) financing between 25 and 40% and foreign currency (FX) financing between 60% and 75%.

[17] DeM strategy: see Table 3-Indicators of refinancing risks, 2012-2016, Table 4-Share of loans with fixed and floating rates, 2011-2016, Table 6-Interest rate risk indicators debt, 2012-2016.

[18] See Table 5 Effect on public debt servicing of change in floating interest rates.

[19] Table 10, Ratio of foreign currency debt repayments to CBA foreign assets*, 2012-2016.

[20] Table 9, The effect of 1% change of AMD exchange rates on public debt (bln AMD)

[21] In Table 10, the comment that there is no FX risk because debt service payments are less than 10% of CBA foreign assets is incorrect and inconsistent with the subsequent statement that some of these payments need to be hedged.

Average Time to Re-fixing (ATR) are not in tune with the analysis[22] and the high cost of local currency (LX) debt is not adequately factored in the analysis.

Dimension 2: The decision-making process is scored with A since the strategy proposal is prepared by the principal DeM entity with the formal participation of CBA, approved by the Cabinet, published in the MoF website and updated annually[23].

DPI-4 Evaluation of Debt Management Operations

Dimension	Score
1. Level of disclosure—in an annual report or its equivalent—of government DeM activities, central government debt, evaluation of outcomes against stated objectives, and compliance with the government's debt management strategy	C

Reporting responsibilities for external debt are established in Chapter IV of the Public Debt Law. It states that the MoF shall on an annual basis report on the state debt and current obligation as part of the Budget Execution information provided to National Assembly.

To comply with this requirement, the Back Office prepares an annual report and sends it to the Budget Execution Division in Treasury for revision. This unit sends it to the Government and then to National Assembly. It is published in the website with a 5 month-lag. The content includes debt service payments planned and actual; deficit financed through domestic and external borrowing; external disbursements in USD and AMD, domestic debt service payments and transactions and stock composition of outstanding Government securities.

Secondly, the current DMS reports results for the period of 2011-2013 on the financing of the deficit, the behavior of the main indicators and general developments including: organizational restructuring of the department, acquisition of DMFAS for debt recording, improvement in the transparency and predictability of the issuance program, reduction in time needed for organizing the auctions, training programs for staff, and coordination with CBA to eliminate the issuance of CBA securities in the market[24].

Thirdly, an Annual Report is sent to National Assembly and uploaded in the MoF website includes data statistics on debt stocks and flows, composition of external and domestic debt; risk analysis including a comparison between targeted and actual risk indicators; and a brief report on the activities of the debt department related to operational risk.

At the same time, none of the reports explain the way in which the strategy decision has assisted in achieving the DeM objectives.

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[22] ATM in table 3 and ATR in table 6 decline for the entire portfolio during the horizon of analysis even though the indicators improve for the domestic debt. This is not well explained in the DMS and is inconsistent with some statements about interest rate risk.

[23] See http://www.mfe.am/index.php?cat=79&lang=3.

[24] See "Public Debt Management Strategic Plan 2014-2016" pages 3-4.

The minimum requirement for score C is met because the annual report provides details of government DeM activities and outstanding central government debt. A higher score cannot be granted because of the lack of an evaluation of how the government DeM activities have complied with the government's DeM strategy.

DPI-5 Audit

Dimension	Score
1. Frequency of internal and external audit of central government debt management activities, policies, and operations, as well as publication of external audit reports.	C
2. Degree of commitment to address the outcomes from internal and external Audits	C

The Chamber of Control (CoC) of Armenia is the Supreme Audit Institute (SAI) in RA, as the legal successor of the Chamber of Control of the National Assembly (NA). It is charged with the responsibility of performing external audit over the utilization of budget resources by the Constitution and the Law on Chamber of Control. The appointment of chairman of the CoC is recommended by the president and approved by NA for a 6-year term. The CoC conducts financial, compliance, performance and environmental audit according to the Law on Chamber of Control. The areas of the external audit are stated in the annual audit plan, which is subject to the approval of the NA.

An external audit of the Treasury system of RA was conducted by the CoC in 2011 and concluded in March 2012. Several areas of government debt management including domestic debt market operations, the issuance of government guarantees and on-lending were covered in the audit. The audit was a combination of financial, compliance and performance audit. The financial information of domestic loan guarantee issuance, on-lending and domestic issuance was checked and verified. The procedure and relevant documents for each operation were reviewed for the compliance of related laws, regulations and policies. On the performance of domestic issuance program, the auditor compared the realized borrowings, repayments and debt services with the budgeted ones and the deviations were noted. The effectiveness of the procedures was examined. For example, the audit report indicated that the procedure of extending an existing loan guarantee were not defined in the relevant policy and suggested further clarification in government regulation. On the transparency of the domestic debt market, it was also indicated by the audit that out of 21 commercial banks, only seven were primary dealers. The selection criteria were not clearly defined and documented as required by the government decree.

As for the internal audit, the Internal Audit Department of MoF was established in December 2011 and its activities are defined and regulated by the Charter of Internal Audit Department and internal audit rules are followed. The department reports to Internal Audit Committee comprising of four deputy ministers. Annual audit plan is developed based on the risk assessment for each department in MoF and adjunct institutes. No internal audit on PDMD has been undertaken in the past and the first such audit is planned for May 2014.

According to the Law on CoC, the conclusion of the audit should be submitted to the NA, and notifying the President and the Government of RA after being approved by the Board of the CoC.

The audited entities should provide written responses to the findings of the audit report within one month.

The follow-up activities by the government by December 2012 in response to the Treasury system audit are summarized and published on the government website along with the audit report. Concerning the revealed issues related to debt management, the explanations are provided or the follow-up measures reported. The audit has led to an amendment to the Government Decree No 380 on budget guarantees. A provision was added to clarify the procedure of extending the government guarantees. As for the lack of documented criteria for selecting primary dealers of government securities required by the government regulation, it is reported that the draft was under discussion with CBA and market participants. By the time the mission took place, the draft was not yet finalized.

Dimension 1: The Treasury system audit conducted by CoC contained the components of financial and compliance audit, as well as the performance audit of some aspects of government debt management. These meet the minimum requirements for score C in the first dimension. Internal audit of government debt management is not undertaken which is required for score B.

Dimension 2: The results of the external audit were followed up and addressed by the government and a score C is given. Corrective actions were taken promptly on some matters (e.g. extending loan guarantee), but delayed on other matters (e.g. selection criteria for primary dealers of government securities), so the requirements for a higher score are not met.

Coordination with Macroeconomic Policies

DPI-6 Coordination with Fiscal Policy

Dimension	Score
1. Coordination with fiscal policy through the provision of accurate and timely forecasts on total debt and debt service under different scenarios.	D
2. Availability of key fiscal variables and/or an analysis of debt sustainability, and the frequency with which debt sustainability analysis is undertaken.	A

The development of the Medium Term Expenditure Framework (MTEF) precedes the drafting of the state budget each year. The MTEF covers three years starting from the next fiscal year and provides the policy guidance and planning for medium term expenditures. It is the basis for the formulation of an annual budget. The process of drafting state budget from the next year starts from late July after the MTEF is approved by the Government.

The Department of Budget Process Management (DBPM) is charged with the responsibility of formulating and compiling a MTEF and an annual budget. During the process, DBPM and PDMD closely coordinate and frequent information exchanges take place. Notably, the DMS is fully integrated with the MTEF; and the deficit financing gap is generated based on the forecasts of revenues, expenditures requests submitted by the line ministries, as is the basis for preparing the domestic borrowing plan and projected external financings.

During the budgeting process, PDMD is charged with the presentation of the borrowing plan and estimated debt service forecast to the budget. For external loans disbursements, DBPM collects the information on projected disbursements for the existing and new external loans directly from the project implementation units (PIUs). The summary of the disbursement plans is provided to PDMD. The PDMD's view on projected disbursements is also incorporated.

The conversion of foreign currency flows into Drams is facilitated by the application of a fixed exchange rate that remains unchanged for the fiscal year as agreed by MoF and CBA[25]. Based on the disbursement schedule and terms and conditions of the loans, PDMD calculates the external debt interest payment and repayment profile on loan-by-loan basis. On domestic side, PDMD comes up with the forecasted repayment of the principal taking into account the domestic borrowing plan and projects the interest payments accordingly. The interest rates are estimated based on historical data and in general are on the conservative side. DBPM has been satisfied with the degree of coordination with PDMD and timeliness of the provisions of the forecasts.

Table 2 Bln. AMD

	2010			2011			2012		
	Budget	Actual	Diff.	Budget	Actual	Diff.	Budget	Actual	Diff.
Total interest payment	37.1	30.4	-17.9%	42.6	35.5	-16.6%	47.7	40.6	-14.8%
of which:									
Domestic debt	17.4	15.8	-9.1%	24.4	20.7	-15.2%	26.2	23.2	-11.3%
External debt	19.7	14.6	-25.7%	18.2	14.8	-18.4%	21.5	17.4	-19.1%

Even though the exchange rates do not need to be forecasted, debt service projections are inaccurate. The comparison between the projected and actual interest payment are presented in the Table 2. As informed by PDMD, the main sources of deviation are 1) significant share of debt with floating interest rate (23.1 percent of total debt as of end-2012) and short-term securities (15 percent of domestic debt as of end-2012); and 2) low predictability of loan disbursements. Normally only 50 to 60 percent of the projected disbursements are realized. The accuracy of the interest payment forecast is expected to improve in the future due to early repayment of Russian loan and reduced share of floating interest rate debt. Sensitivity and scenario analysis of debt service projections are also not conducted for budgeting purposes.

Macroeconomic projections are produced by the Department of Macroeconomic Policy in MoF, which are used for the MTEF and annual budget preparation and formulation. The macroeconomic indicators and projections are shared with the PDMD through the budgeting process and other formal consultations.

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[25] The exchange rate as of N 1st is used for the Budget law and includes US dollar, Euro, Japanese Yen, and British Sterling.

Debt sustainability analysis (DSA) is conducted by the Department of Macroeconomic Policy with the participation of the PDMD. The task is undertaken by the government without external assistance since 2011 using the IMF-WB LIC DSA template[26]. Twenty years of projections on external public debt and total public debt under baseline and different scenarios are generated. The DSA is conducted regularly to feed into the development of MTEF and annual budget and when deemed necessary. For instance, DSA was conducted before the issuance of the Eurobond and its conclusions were included in the concept paper. In addition, the main results of DSA are also incorporated and presented in the DMS document devised by the PDMD.

Dimension 1: There is sufficient coordination and information exchange between PDMD and the budget department. However the interest payment forecasts deviated from the budgeted by 15 percent or more for past three years. To score C on the first dimension, it requires the higher accuracy of the forecast, so the score D is given.

Dimension 2: The second dimension is scored A since DSA is conducted in house at least annually.

DPI-7 Coordination with Monetary Policy

Dimension	Score
1. Clarity of separation between monetary policy operations and DeM transaction.	B
2. Coordination through regular information sharing on current and future debt	A
3. Extent of a limit to direct access of resources from the Central Bank.	A

Since 2006 CBA adopted an inflation-targeting framework for monetary policy characterized by the public announcement of target ranges for the inflation rate over a 12-month horizon (4 percent and +/- 1.5 percent band for 2013). Interest rate is the operational goal, with the CBA Board deciding on the level of CBA repo rates aimed at minimizing deviations from projected targets. The CBA conducts a freely floating exchange rate regime consistent with a liberalized capital account and implementation of an independent monetary policy.

Monetary policy is mainly implemented through repos using government securities as collateral. Weekly auctions take place on Wednesdays. In the past, CBA would request MoF to issue T-Bills for monetary operations to sterilize capital inflows. These T-Bills, used for coordinating fiscal and monetary policy, had a maturity of 4-12 weeks and were different from those used for cash management (1-3 weeks), or for deficit financing (13-52 weeks).

The arrangement for MoF to issue T-Bills for monetary operations is still in place but has not been used for the last two years because CBA has already built a substantive stock of repos and government securities sufficient to deal with the liquidity levels in the banking system. The arrangement stipulates that the proceeds of monetary T-Bills should be deposited in a special

[26] The Excel-based tool is jointly developed by the World Bank and IMF to support low-income countries (LICs) to conduct debt sustainability analysis. It comprised two templates: the LIC External Template and LIC Public Template.

account at the CBA that yields a return equal to the yield of the T-Bills; therefore, the CBA and not the MoF covers the cost of monetary policy operations implemented with these securities.

CBA does not interfere in the issuance program of Government securities but recommends that there be sufficient issuance to assure price signals at different maturities in the yield curve.

Relations between CBA, as financial agent of the Government and MoF are not regulated under a single formal agreement but rather in separate agreements dealing with specific issues. Furthermore, additional guidelines have been issued separately, both at CBA and MoF on how to implement the agreement in each institution. The agreements however are not published.

Dimension 1: The minimum requirement for this dimension is met since monetary policy operations are formally separate from debt management transactions. This dimension is scored B because in addition, the agency relationship between CBA and the central Government is specified in a formal agreement. If such an agency agreements were to become publicly available, the requirements for a score of A would have been met.

Formal coordination and information sharing between the CBA and the MoF takes place throughout the year. There are eight meetings a year for interest rates setting, where monetary policy is discussed and where the MoF is represented by the Deputy Minister: he has voice but no vote. In addition, there are weekly meetings attended by both institutions: on Thursdays at MoF to monitor budget execution and cash forecasts; and on Fridays at CBA for monetary policy coordination. Furthermore, daily informal meetings take place at CBA where participants discuss relevant issues of the day, as well as daily phone conversations between CBA and MoF staff.

The cash flow forecasts produced by PDMD are currently shared with CBA on a weekly basis, during the Budget Implementation Meeting, and include quarterly estimates with weekly updates.

Dimension 2 : This dimension is scored A because of the frequency of coordinating meetings between CBA and MoF for sharing information on debt transactions and cash flow forecasting takes place on a weekly basis.

Article 34 of the Central Bank Act prohibits CBA from extending credit to the Government. In fact, there has been no lending to Government for at least the last decade. Furthermore, the "Law of the Republic of Armenia on the budgetary system" also prohibits any borrowing from the Central Bank.

Dimension 3: The current regulatory framework at the CBA does not allow extension of any credit to the Government, which satisfies the requirements for an A rating on this dimension.

Borrowing and Related Financing Activities

DPI-8 Domestic Borrowing

Dimension	Score
1. The extent to which market-based mechanisms are used to issue debt, the publication of a borrowing plan for T-bills and T-bonds, and the preparation of an annual plan for aggregate amount of local currency borrowing in the domestic market, divided between the wholesale and retail markets.	A
2. The availability and quality of documented procedures for local currency borrowing in the domestic market.	A

The MoF issues T-bills up to 1 year, medium-term T-Notes from 15 months to 5 years and long-term T-Bonds from 6 to 30 years. These securities represent close to 98 percent of the domestic debt portfolio.

Decree 1580[27] issued by the Cabinet determines conditions of issuance of T-Bonds including the role of CBA, MoF and Primary Dealers (PD) in the auctions, custody and secondary market. Decree 142-N issued by the Board of CBA[28] sets the operational procedures for: (i) Auctions, buybacks and redemption; (ii) Central Depository; and (iii) Operations in the secondary market.

Issuance takes place through closed auctions to PD[29]. T-bills are issued through weekly auctions; medium-term notes monthly and long-term bonds quarterly[30]. Both T-Bills and T-Bonds can be reopened.

The strategy and the benchmark program determine the type and volumes of issuance presented in an annual borrowing plan prepared by the Front Office[31]. A range with indicative amounts is announced one month ahead of the auction date. The issuance program has minor updates during the year and is highly predictable according to market participants.

The auction process is fixed-volume variable-price, with a maximum interest rate cut-off established by MoF prior to the auction. Multiple-price is used for all securities. Full announcement occurs 7 days before the auction for T-Bonds, 3 days for T-Bills with more than 13 weeks to maturity and one day for T-Bills with less than 13 weeks to maturity. The announcement is posted on the websites of both MoF and CBA.

[27] Cabinet decree dated 27 December 2008 includes in Appendices 1 and 3 terms of the issuance process of T-Bills and T-Bonds; and in Appendices 2 and 4 rules for allocation circulation and redemption of T-Bills and T-Bonds. Decree 1580 is available on the websites of the MoF and CBA.

[28] CBA decree dated 7 February 2013.

[29] T-Bills auctions used to be open to all investors, but were restricted to PD 3 months ago.

[30] Medium-term notes are reopened for a period of one year; 7- and 10-year bonds are reopened for 2 years; and 20-year bonds for 4 years. The calendar is fixed and the amounts vary in a narrow band.

[31] The mission has copy of the issuance program for 2014.

Bidding through a CBA system opens at 3:00 pm on the day prior to the auction and closes at10:30 am on the auction date. The bids are processed at CBA in the presence of one staff from CBA and one from MoF. Auction cut-off is approved by the Chief Treasurer of the MoF within half an hour of the closing and the results are published on the CBA website 2 hours after the closing[32]. Clearing and settlement is done within CBA, which manages the payment system and is the Central Depository[33].

Upon receipt of CBA's auction results, the securities issued are entered into a debt recording database maintained in Excel. The operation is usually done by an official and verified by the Head of the Back Office.

Dimension 1: Armenia scores A in the first dimension because the bulk of the domestic funding is raised using market-based instruments and a borrowing plan for T-bills and T-bonds is presented one year ahead that contains issue dates and instruments. This score is granted even though the annual borrowing plan is not divided between the wholesale and retail markets, given that the retail is only 0.4 percent of the existing stock of government securities.

Dimension 2: The second dimension is rated A because the terms and conditions, borrowing procedures, and criteria for access to the primary market for all T-bills and T-bonds are publicly available on the central bank website.

DPI-9 External Borrowing

Dimension	Score
1. Degree of assessment of the most beneficial/cost-effective borrowing terms and conditions (lender or source of funds, currency, interest rate, and maturity).	D
2. Availability and quality of documented procedures for external borrowings.	D
3. Availability and degree of involvement of legal advisers before signing of the loan contract.	A

Until September 19, 2013, Armenia's external debt was comprised exclusively of multilateral and bilateral loans. On that date, the Government launched its first Eurobond[34].

Financing needs of the Government typically exceed the supply of concessional financing, which according to the DMS should be preferred to other sources. This guideline is reinforced by the Letter of Intent with the IMF that requires keeping a grant element on all external loans of at least 30 percent[35].

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[32] The authorities have plans to outsource to NASDAQ OMX organization of auctions and will consider outsourcing also the clearing and Central Depository. The ultimate objective is to have a sophisticated infrastructure that is attractive to foreign investors.

[33] Cash accounts of bidders are blocked after the presentation of the bids to allow for a settlement at t+0.

[34] The inaugural international 7-year bond with 6 percent coupon for USD700 million was priced at 6.25 percent yield, the bid to cover ratio was about 4 and Deutsche Bank, HSBC and J.P. Morgan acted as Joint Bookrunners on the transaction.

[35] An exception was made for the Eurobond.

Most creditors' terms and conditions are non-negotiable; however IBRD, ADB (ordinary capital resources window), EBRD and EIB leave to the borrower the choice of repayment schedule, interest rate type and, in some cases, the currency of the loan.

The desired financial features of the loans are selected at the portfolio level in the DMS (see DPI-3) and an annual borrowing plan is presented in the budget including all individual external loans. However, this reflects mainly the pipeline of project loans and not a cost analysis.

For every loan, the PDMD checks the grant element and the financial conditions. If given a choice, the PDMD tends to recommend the maximum average maturity[36], fixed interest rates and USD as the preferred currency, in line with the DMS. These recommendations are provided to the negotiating team in a letter that summarizes MoF's assessment of the draft loan contract[37].

The recommended terms may change as a result of the negotiations. Once these are concluded and the agreement is signed, the Head of the Back Office prepares a term sheet that goes to the Legal Department in the MoF, then to the Ministry of Foreign Affairs, the Constitutional Court and finally to National Assembly, as part of the package for ratification[38]. Simultaneously, staff in the Back Office enters the loan contract into DMFAS with an estimated effective date.

Drafts of the legal agreements are usually provided before the start of the negotiations, which allows MoF's Legal Department to be involved at an early stage of the process. The opinion of the Legal Department is included in MoF's letter provided to the negotiating team as a guideline. After negotiations are concluded, the letter is updated and includes the clearance provided by the Legal Department. In some cases the Ministry of Justice participates in the negotiations. However, these procedures are not documented in secondary legislation.

With regard to the Eurobond, its launching was preceded by the preparation of a Concept Paper that was annexed to the government's decision. The Paper included debt sustainability considerations, estimated impact on main debt ratios under different market scenarios[39] and a detailed schedule of the different stages of the issuance process. This schedule was developed with the guidance of an international consultant and needs to be completed with the roles of different participants in the MoF and adopted as internal procedures for future operations.

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[36] However, the Head of the Back Office presents alternative repayment schedules to the Head of the Public Debt Department.

[37] Such a letter involves also the opinion of the Budget and Legal Departments and is drafted by the International Department.

[38] The loans subject to the Law for International Agreements present three stages: (i) loan negotiations involving MoF, line Ministry and sometimes the Minister of Justice; (ii) signing of the agreement involving the Ministry of Foreign Affairs and the Staff of the President's office; and (iii) ratification of the agreement involving MoF, Ministry of Foreign Affairs, Constitutional Court, Parliament, and Ministry of Justice.

[39] See "Concept Paper on issuing foreign currency bonds in the international capital market" approved in May 16, 2013. Annex 3 includes projections of debt stock and flow ratios over GDP under different interest rate scenarios and issuance volumes.

The Eurobond couldn't have been issued without the participation of an international legal advisor who led the MoF in the different stages of the process[40]. The Ministry of Justice acted as the local legal advisor.

Dimension 1: The first dimension is rated D. Although PDMD prepares yearly borrowing plans for external borrowing, which include projected disbursements from existing and new loans, it is not based on an assessment of the most cost-effective terms.

Dimension 2: The second dimension is rated D because of the lack of internal documented procedures for all external borrowings[41]. Also the Back Office instead of Front office participates in the loan negotiation and prepares term sheets.

Dimension 3: The third dimension is rated with A because legal advisers of the MoF are involved from the beginning of the loan negotiations.

DPI-10 Loan Guarantees, On-lending and Derivatives

Dimension	Score
1. Availability and quality of documented policies and procedures for approval and issuance of central government loan guarantees.	D
2. Availability and quality of documented policies and procedures for on-lending of borrowed funds.	C
3. Availability of a DeM system with functionalities for handling derivatives and availability and quality of documented procedures for the use of derivatives.	N/R

In line with the RA Law on Public Debt, the Government has the right to issue domestic and external guarantees to residents, non-residents, foreign states and international organizations. Also, the Budget System Law of the RA includes a fiscal rule related to the maximum amount of government guarantees which could be issued within one fiscal year (art.11)[42].

De facto, the current portfolio of government guarantees consists of one outstanding domestic guarantee in the amount of AMD 1 billion and several outstanding external guarantees issued by MoF with prior approval of the Cabinet of Ministers for some external credits/loans borrowed by CBA. As government guarantees are considered part of the direct government debt, their issuance has to be coordinated with the Government and decisions are to be submitted to the National Assembly for ratification.

[40] Refer to the Ibid (see table 4 pages 9 and 10).

[41] The Law for International Agreements does not provide the procedures for the different units of the MoF to follow; these should be issued by internal orders.

[42] Article 11: The total amount of liabilities for which budget guarantees in the current fiscal year are provided shall not exceed 10 percent of tax revenues collected in the previous fiscal year (except for the guarantees provided under international agreements signed on behalf of the Republic of Armenia). The amounts calculated in this way can be increased every subsequent year by 5 percent, except for the cases where there is a decline in tax revenues in comparison with the previous year.

At the time of the mission, external government guarantees were not formally recorded in the DSBOM of the MoF, therefore the total amount of outstanding government guarantees could not be verified (see DPI-14).

The issuance of government guarantees is guided by the formal policies and procedures approved by the Cabinet.[43] In theory, such procedures should be followed for issuance of any type of government guarantee, although *de facto* they have been followed so far only for issuance of domestic guarantees.

The government procedures provide a description of the requirements to be followed when issuing guarantees. Business plans, audited accounts, project descriptions and cash flow forecasts should be provided to MoF. No entities with tax debts could seek a government guarantee. The MoF reserves the right to deny the issuance of the guarantee if the requirements are not met.

Dimension 1: As existing procedures for issuance of government guarantees were not applied for issuance of external guarantees, the minimum requirements for the first dimension are not met and the score is D.

The MoF DSBOM is in charge of lending and on-lending of the government funds to the final beneficiaries. The procedures for such operations are identical, as specified in the government Decision 168 from 09.03.1998.

For the purpose of the portfolio management, there is no clear division of the budget lending or budget on-lending, and no separate estimation of the size of on-lending portfolio. According to the DSBOM, currently, the size of the on-lending portfolio is around USD 1 billion, formalized through around 100 on-lending agreements.

For the on-lending transactions, MoF is passing the foreign currency exchange rate risk to the final beneficiary, as the agreements are signed in the original currency of the external loan.

Credit risk analysis may or may not be conducted for each individual on-lending transaction, and the criteria for such analysis are not formally defined by any guidelines.

Dimension 2: As the procedures for on-lending transactions exist and are being followed, the minimum requirement is met and score C is assigned. For a higher score, formal guidelines for risk assessment should be in place and followed.

Dimension 3: The Government has not entered into any derivative contracts. The third dimension is therefore not rated.

[43] Government decision nr.380 from 30.06.1998 on approval of issuance of budget guarantees.

Cash Flow Forecasting and Cash Balance Management

DPI-11 Cash Flow Forecasting and Cash Balance Management

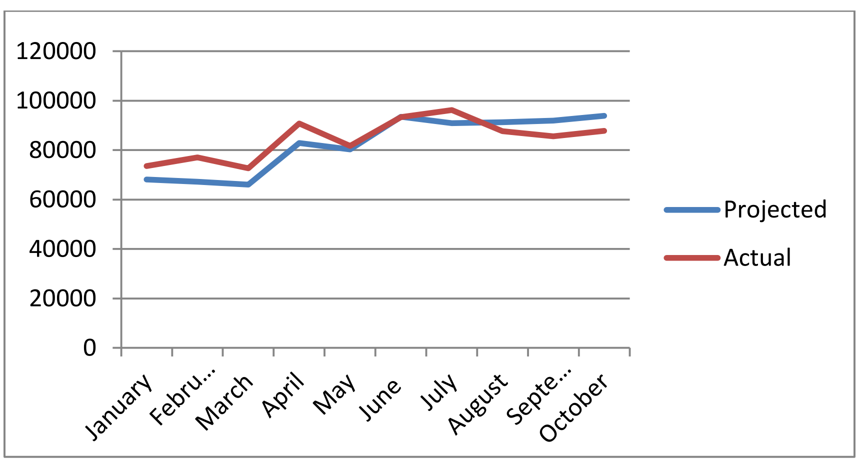
Dimension	Score
1. Effectiveness of forecasting the aggregate level of cash balances in government	C
2. Effectiveness of managing the aggregate cash balance in government bank account(s), including the integration with the domestic debt borrowing	A

The middle office office at the PDMD is responsible for preparing Government's cash balances and cash flow forecasting. In the first instance, it is prepared on an annual basis at the beginning of the budget year, based on information supplied by the Budget Department, and broken down on a quarterly basis. Thereafter, forecasts are updated on a monthly basis, five days before each month. The middle office makes weekly forecasts for the month ahead and then during the month makes adjustments to the weekly forecasts using actual data. Overnight cash balances forecasts are not available.

Projections are prepared on an Excel spreadsheet based on historical patterns as reference. Although most of the projections are fairly accurate, tax receipts, for which the front office does not receive forecasts for the year, have become harder to estimate. There is a government decision mandating the SRC to submit these estimates, but there is no compliance.

Forecasts are discussed weekly, every Thursday, at the Budget Execution meeting where the weekly estimates updates are also submitted to CBA. Forecasts are considered reliable. On a monthly basis, estimates tend to be within 8 percent of the actuals for the month and the average for the year is within 3 percent (see Chart 4). Although no overnight cash balances are currently produced, actual daily data from the previous year are used to prepare weekly estimates.

Chart 4: Cash flow forecasting, projected vs. actual 2013

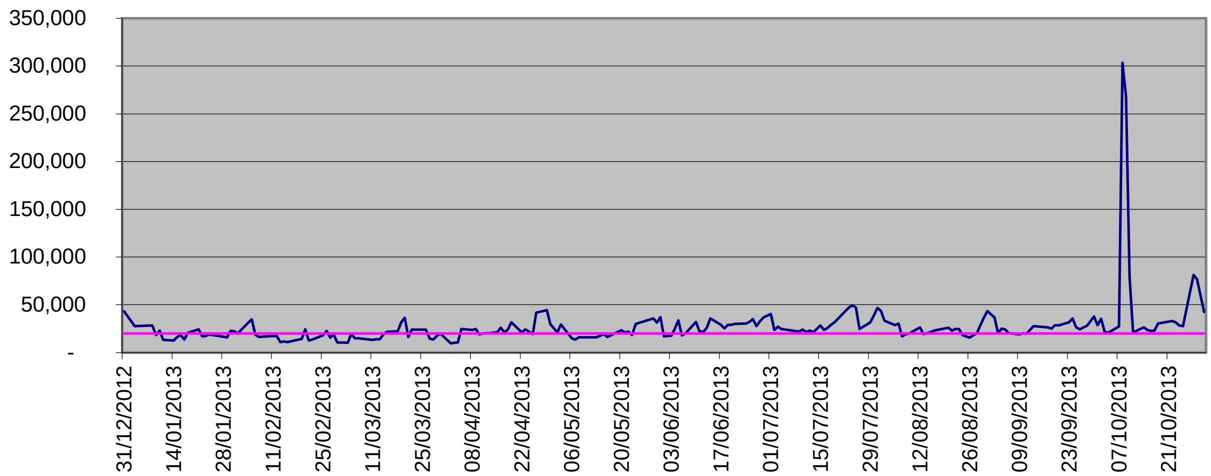


Source: PDMD, Ministry of Finance. 2013

Dimension 1: Since monthly forecasts of the weekly aggregate level of cash balances in central government account are being produced, the minimum requirements for this dimension are met and the score is C. To get a score of B overnight cash balances would have been necessary.

The front office at the PDMD is responsible for the investment of excess cash balances. Treasury tends to experience excess liquid positions during the first half of the month when tax revenues are collected and liquidity is drawn down in the second half when payroll and other expenditures are met. To determine the magnitude and horizon of excess liquid positions, the front office receives cash flow forecasts from the middle office on a weekly basis while statements of the TSA are provided by CBA via CBANET in real time and communications between the two institutions take place throughout the day. There is no formal cash surplus target at the TSA, however, informally the front office tries to maintain the TSA balance above a threshold of AMD 20 billion and if balances exceed the target level, excesses are placed in a CBA facility.

Chart 5: Daily balances, Jan-Oct 2013 in Million AMD at TSA

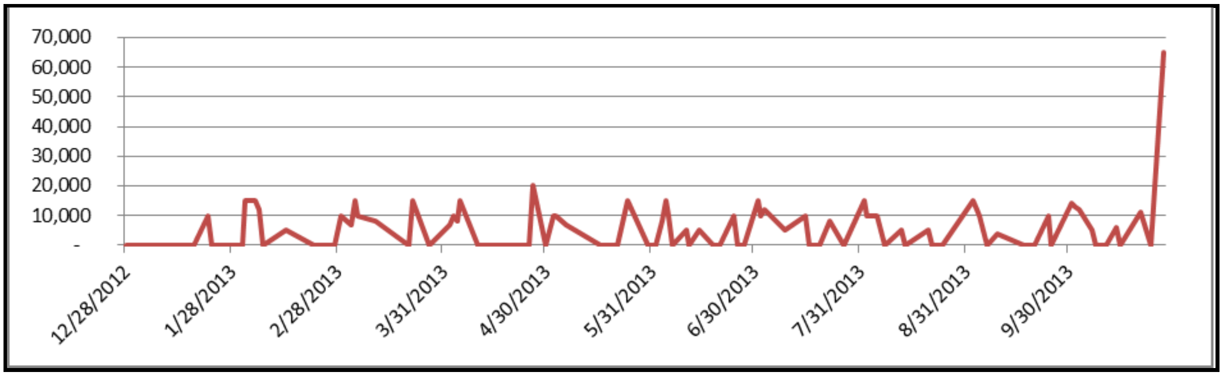


Source: PDMD, Ministry of Finance. 2013

CBA investment facility consists of time deposits ranging from 15 days to 1 year whose rates are in line with interbank repo rates[44]. The average time of government's deposits in 2013 has been 47 days. Chart 5 above presents cash balances at the TSA. Chart 6, on the other hand, shows the investment operations undertaken during the last year by the front office. It shows that these operations are done around 3 times a week for an average amount of AMD 11 billion. The spike towards the end of the period, both in terms of balances and investments, is the result of the inflows after the successful issuance of a Eurobond.

[44] Treasury recently proposed adding a 7-day time deposit and CBA is considering the proposal.

Chart 6: Investment amounts in million AMD



Source: PDMD, Ministry of Finance. 2013

In addition to time deposits, PDMD regularly conducts buyback operations to mitigate refinancing risk and to provide liquidity to benchmark securities. These operations however are not intended to reflect active cash management.

Dimension 2: The score for this dimension is B because central government manages its cash in excess of the target on at least a weekly basis with the central bank at markets rates. In order to score an A, government should manage its cash excesses on a daily basis.

Operational Risk Management

DPI-12 Data Administration and Data Security

Dimension	Score
1. Availability and quality of documented procedures for the processing of debt service.	D
2. Availability and quality of documented procedures for debt data recording and validation, as well as storage of agreements and debt administration records.	D
3. Availability and quality of documented procedures for controlling access to the central government's debt data recording and management system.	D
4. Frequency and off-site, secure storage of debt recording and management system backups.	D

Although existing practices across PDMD office and tasks seem to facilitate processing debt service and data recording, there is a lack of specific written documented procedures to guide all these tasks. Debt service payments for external debt originate at the back office. When the due date for a loan payment approaches, staff in charge of debt service projections prepares a "request for financing" which is checked by the Unit manager and sent to the Treasury for approval. After it is approved by the Treasury, the same staff member prepares a payment order electronically using the Treasury network system, it is approved again by the unit manager and is sent directly to the CBA to be executed. For domestic debt service, according to the Agreement between CBA and MoF, payment is issued automatically by the CBA system and a copy is sent to Treasury and the back office of the PDMD for recording and monitoring.

Dimension1: Because of the lack of detailed written documented procedures regarding the issuing of payment orders, the score for this dimension is D. To meet minimum requirements for a score of C, all existing practices would need to be recorded and approved as procedures manuals.

The responsibility for maintaining the government debt database lies with the back office of the PDMD. There are four staff plus a director working in this unit. Furthermore, the responsibility for assigning work related to specific creditors to the different staff members is that of the director. The database is being kept up to date, and loan information is checked against creditor's invoices every time they are received (i.e., twice a year). There is one staff allocated to record all disbursements as soon as information from the Budget department is received. Existing practices have facilitated keeping the database current and accurate, however these have not been incorporated into a written procedures manual.

All debt information is usually recorded in a timely manner. Additionally, the database is reconciled periodically and recorded data is validated by the chief of the Unit fulfilling the four eyes principle. An Excel based database for domestic debt kept in the back office unit contains all information and projections for domestic instruments and another database for retail instruments. The CBA keeps an automated in-house developed data Registry with all information about domestic debt holders (except retail instruments). Furthermore, a separate database for government guarantees and on-lending is kept in Excel at the DSBOM. It is backed-up by the IT department but kept at the same storage location as the DMFAS and domestic debt databases.

The original signed copy of loan agreements is kept at the Ministry of Foreign Affairs. Another copy is sent to the Legal Department of the MoF and to the Back Office unit. Copies of the agreements are also scanned and stored electronically. Copies of these agreements as well as debt administration documents are kept and administered by the Back Office. They are stored in file cabinets which are locked but are not fire proof. The offices in which they are located are locked, and the building has 24 hour security at the entrance. Documents for guarantees and on-lending are kept at the department office in file cabinets that cannot be locked and are not fire proof.

Dimension 2: The lack of quality and detailed documented procedures for debt data recording and validation, as well as storage of debt administration records do not meet the minimum requirements for this dimension, and it is rated D. To get a C, existing practices would need to recorded and approved as a procedures manual and the loan administration documents should be stored in a fire and flood proof filing system in addition to the existing theft proof facility.

Access to the debt management system is controlled with username and password codes. Issuing codes for accessing the Ministry's network from individual PC is controlled by the Ministry's IT department. Additionally, accessing the debt recording system (DMFAS) also requires passwords and access numbers which are issued by the DMFAS' IT support specialist (a part time consultant). These codes allow identifying who accessed the system and the changes made under the user id, providing an audit trail. Procedures for issuing these codes are not written and the request by the manager to the IT specialist for issuing the security codes is done verbally. The database kept at the CBA is equally protected with user id and passwords. Furthermore, at the CBA, there are written procedures for issuing, changing, and cancelling these security codes.

Dimension 3: The score for this dimension is D because of the non existence of written procedures for issuing security codes for accessing the debt recording database kept at the MoF.

The IT department at the MoF carries out a back-up of the debt recording system on a daily basis, and the back-up copy is kept at MoF's Central Building in the same location with sufficient protection from theft and fire but not flood. The excel file containing domestic data base for Government securities and the retail instruments are back up weekly but on a USB which is kept at the same office. The debt recording system at the CBA is back-up on a daily basis and a security copy is saved at a separate location.

Dimension 4: The existing frequency of back-ups would be sufficient to get a score of C but the fact that the storage facility at the MoF is located at the same building and it is not flood proof does not meet the minimum requirements for this dimension and therefore the score is D.

DPI-13 Segregation of Duties, Staff Capacity, and Business Continuity

Dimension	Score
1. Segregation of duties for some key factors as well as the presence of a risk monitoring and compliance function.	D
2. Staff capacity and human resource management.	C
3. Presence of an operational risk management plan, including business continuity and disaster-recovery arrangements.	D

At the end of 2011 – beginning of 2012, the PDMD underwent a restructuring and organized itself into functional lines. However the transfer of functions has not yet been fully implemented, resulting in a mix of functionalities across newly established front, middle and back offices. The back office, for example, is in charge of external loans' negotiations, as well as of debt recording and issuing debt service payment orders. Furthermore no entity is responsible for operational risk monitoring and compliance[45].

Dimension 1: The minimum requirement for a C in this dimension is not met. To be a C there would need to be a segregation of duties between the staff in charge of negotiating, recording loan agreements and issuing payment orders. Furthermore, there would be a need for a staff member in charge of risk monitoring, even if the staff does not focus exclusively on this task and clear separation between debt managers in charge of recording and issuing payment orders.

The total number of staff positions in PDMD is 20, with 2 positions vacant at the time of the mission. The number of staff seems to be sufficient and the quality of the job is very sound, as also mentioned by the financial institutions that assisted the MoF in issuing a recent Eurobond. Furthermore, commercial banks participating at the monthly meetings with PDMD have also praised their capacity and good performance.

The number of staff at the DSBOM is 10 and there are no vacancies.

[45] Risk monitoring and compliance would include a continual cyclic process which includes operational risk assessment (identifying potential sources of risk such as procedures, tasks, responsibilities etc), risk decision making and determining which ones are acceptable, which ones can be mitigated and which ones can be avoided. The staff in charge of operational risk monitoring would also need to design a system of risk controls and update it periodically. For a score of C, it does not need to be a full time position.

Job descriptions are available from the Human Resources Department and have been updated to include the recent re-organization of PDMD along functional lines. Job descriptions include tasks to be carried out as well as educational and experience requirements. All staff is evaluated every six months by the managers. This process is done electronically and the final assessment is produced electronically as well. Staff scoring above 75 percent is given a salary bonus.

Currently, there is no formal individual training and/or development plan for each staff member. The Ministry provides a general training program to which civil servants can apply and are required to take at least once every three years. However, the courses offered are not specifically related to debt management. Staff from PDMD has been able to enhance their skills through capacity building program provided by the international partners (IMF, World Bank, EU) at the initiative of the Department. Specific Code of Conduct is available for all civil servants which are tested on it at the time they take the entry exam for the job. A Code of Conduct for civil servants is available for staff working at the MoF, as per article 37.1 of the Civil Service Law. When applying for jobs at the Ministry, candidates are tested for their knowledge. Specific code-of-ethics for PDMD has not been prepared.

Dimension 2: Since there are sufficiently trained staff with detailed job descriptions the minimum requirements for this dimension are met. However, as a specific code-of ethics and conflict of interest guidelines for PDMD has not been prepared the score cannot be a B.

Dimension 3: Many different risks (for example, the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events) can negatively affect the normal operations of an organization. Therefore, there should be a business continuity and disaster recovery plan to cover these adverse effects. These documents have yet to be elaborated and made available for the different departments at the MoF. At the CBA these plans are available and are tested on an annual basis. The minimum requirements for dimension 3 have not been met and it is rated D.

Debt Records and Reporting

DPI-14 Debt Records

Dimension	Score
1. Completeness and timeliness of central government debt records	D
2. Complete and up-to-date records of all holders of government securities in a secure registry system	C

The Government debt of RA defined by the Law on Public Debt comprises of central government domestic and external debt, central government domestic and external guarantee. The Public Debt, along with the Government debt, includes the debt and guarantees issued by the CBA. Under the PDMD, Back Office is in charge of recording the central government debt. The external debt records are kept in DMFAS, which was installed at the MoF in 2011. At the time of the mission, only the external government debt was recorded in the DMFAS, while domestic debt remained in an Excel spreadsheet.

Domestic loan guarantee[46] is recorded and monitored by the DSBOM. The record is kept in Excel. A report compiled by the DSBOM is delivered to PDMD on monthly basis for reporting purposes.

The external guarantees, including the ones provided by the Government to the CBA loans, are not recorded by DSBOM or PDMD of the MoF. The CBA keeps the records of its external debt, which is classified as part of public debt by the Law on Public Debt. The flow statistics of the CBA loans are provided to PDMD within a few days lag for public debt reporting purpose. PDMD is well aware of these loan guarantees, but the records of them are missing.

The central depository of government securities is maintained by CBA on behalf of the central government according to the agreement between the two parties. It is a fully automated book-entry system. During a primary issuance, once the bid is submitted by the primary dealer, the cash leg is frozen in the current account to ensure settlement at T+0, close to DvP[47] basis and the transaction is recorded to the account of the government and primary dealers simultaneously. The allocation to the primary dealers is separated into their own account and nominee account that the bank holds on behalf of its clients. The records in the system are up to date since by design all transactions, including settlement, interest payment, redemption and secondary trading are captured at real-time. Once the transaction is executed, the government treasury and commercial banks are informed instantly. Besides a summary report on their account is sent on daily basis, which serves the purpose of reconciliation. CBA is able to provide the statistics of government security holdings by residency, though the final investors are not identified. This information is shared with PDMD on weekly basis.

The government security Registry is secured by username and password both to the computer and the system. Different level of accessibility is assigned according to the function of the staff by the head of the department. The system is backed up at real time at two servers located in the same building, as well as two off-site reserves at the end of the day. The storage room of the servers is fire and flood proof. It is locked and only the authorized staff has the access. Business continuity plan (BCP) exists and is tested each month. The staff has good awareness of the BCP. CBA received the ISO27001 certificate for IT security management in 2012 and the depository system was part of it. However the audit of the government security registry system has not yet been undertaken.

Dimension 1: Most debt related transactions are recorded in the debt recording system within a few days. Nevertheless the government debt records are deemed incomplete with the external loan guarantees not recorded, so score D is granted for the first dimension.

Dimension 2: The registry system kept by CBA contains up-to-date and secure records of all holders of government security, so the second dimension meets the minimum requirements of score C. To score higher, the registry should be subject to the periodical audit, which has not taken place yet, so the score is C.

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[46] Currently only one domestic loan guarantee is outstanding.

[47] Delivery versus payment (DvP) refers to the security settlement system that the buyer's payment is due at the time of delivery.

DPI-15 Debt Reporting

Dimension	Score
1. Meeting statutory and contractual reporting requirements of central government debt to all domestic and external entities	D
2. Meeting of statutory and contractual reporting requirements for total non-financial public sector debt and loan guarantees to all domestic and external entities	N/R
3. Quality and timeliness of the publication of a debt statistical bulletin (or its equivalent) covering central government debt	D

The Back office takes the responsibility of reporting public external debt to the World Bank Debtor Reporting System (DRS). The reporting includes central government and central bank debt. By way of reporting, the central government debt can be separated from central bank debt. The feedback from the WB on the past reporting is good without outstanding issues.

RA is the subscriber of IMF Special Data Dissemination Standard (SDDS) and the statistics are disclosed on the National Statistical Service (NSS) website. The PDMD is responsible for the reporting of the central government debt. According to the observance report produced by the IMF for 2012, Armenia had been timely in reporting all the indicators. Central government debt is reported on quarterly basis with two months of lag, exceeding the IMF's requirement of three months lag. However the mission finds that the current reporting of central government debt covers the CBA debt as well. The practice is not compliant with the SDDS standard and the Government Finance Statistics Manual.

RA has no statutory or contractual obligations to report total nonfinancial public sector debt and loan guarantees to domestic or external entities.

The monthly Bulletin on Public Debt is published online in both Armenian and English. The bulletin containing the statistics as of the end of the month becomes available within five days of the reported period. In the bulletin, public debt is divided into government debt and the central bank debt, where the government debt is decomposed into the domestic and external debt based on residency[48]. The domestic guarantees issued by the government are reported under the government domestic debt. To avoid double counting, the external guarantees issued by the government in favor of the CBA are reported under CBA external debt, but not the government debt. The treatment complies with the provision of Law on Public Debt (Article 23 Provision 8)[49]. The amount of the loan guarantee is indicated and a proper note is provided. The government domestic and external debts are further disaggregated by instruments. The volume of the debt is reported in both AMD and USD terms. Debt flow statistics on government debt, which is relevant to budget implementation are disclosed in details as well. These include monthly and year-to-date interest payment by residency, loan disbursement and repayment by residency, and placement and

[48] According to the Law on Public Debt, the debt is classified as domestic and external debt based on residency.

[49] Article 23 Provision 8 of Law on Public Debt states that "(e)xternal state guarantee provided by the Government to the Central Bank shall be accounted for as debt of the Central Bank".

repayment of government securities. The stock of government securities is broken up into short-term, medium-term and long-term based on original maturity.

More detailed statistics are reported on public external debt (including CBA debt) portfolio including decomposition by creditors, currency and interest rate basis.

In addition, annual and semi-annual reports of RA public debt are published on the website of the MoF, and annual ones are also available in hard copy and in English. The 2012 annual public debt report provides some analysis on portfolio risks, while a few basic risk indicators are missing or only cover part of the portfolio, including debt decomposition by residual maturity, average time to interest rate re-fixing average maturity of the debt (only for government security) and maturity profile of the debt. The annual report is published within six months of the reporting year. Since the scope of the disclosure focuses on public debt, certain information is only available for public debt portfolio but not for government debt, including debt stock by currency and interest rate basis.

Dimension 1: Armenian government has been timely in reporting to the WB DRS and compliance with SDDS. But the coverage of SDDS reporting does not conform to the reporting requirement, so the first dimension is rated D.

Dimension 2: The second dimension is not rate (N/R) on the basis that there are no statutory and contractual reporting requirements to report nonfinancial public sector debt and loan guarantees.

Dimension 3: The government has made great effort in publishing monthly public debt statistical bulletin as well as annual and semi-annual public debt reports. Since the scope of the disclosure focuses on public debt, certain information is only available for public debt portfolio but not for government debt, including debt stock by currency and interest rate basis. Besides there lacks the breakup of debt stock by residual maturity for either public debt or central government debt. The third dimension is rated D for a few statistics on central government debt required for score C are not reported, including government debt stock by currency, interest rate basis and residual maturity.

Annex 1: RoA Ministry of Finance Comments to the DeMPA report (translation from Armenian)

DPI-1 Legal Framework

1. It is stated in the Report that *Public Debt Law does not require annual reporting to the National Assembly and the external audit of debt management activities is also not mandatory although the Chamber of Control has the right to conduct such audit*. However, Article 13.1 of PBL stipulates that at annual reporting to National Assembly on state budget execution government must provide information on public debt and current debt liabilities, furthermore Article 77 of Constitution stipulates that the National Assembly shall examine the annual report on the execution of the state budget and adopt the report based on the findings of the Control Chamber. Subsequently, information of public debt must be submitted to the NA as part of the annual reporting on execution of the state budget, and Control Chamber shall provide its findings thereto. Pursuant to paragraph 25.4 of the RoA Budgetary System Law, Control Chamber must provide to the NA*: (i) assessment of trustworthiness of the figures reflected in the annual account on state budget implementation, and (ii) assessment of the level of compliance with the requirements of the state budgets law of the reporting FY.* Thus, Control Chamber must evaluate both the accuracy of disclosed data on state debt and conformity of debt management activities in the current year to the requirements set forth by law.

2. Report refers to Article 1.12 of the Budgetary System Law, pursuant to which the contracts (agreements), which entail state and local government liabilities, shall be registered in the Ministry of Finance and thereupon enter into force. We consider that this referral is inconsistent as (logically) it refers to liabilities for public procurements.

3. Note 9 seems to say that *Art.23 p.8 of the Law specifies that external guarantees provided by the Government to/for the Central Bank shall be accounted for as debt of the Central Bank. The mission did not come across any such guarantees.* Then is says *Instead, the mission identified external government guarantees to the bilateral and multilateral lenders for the loans borrowed by the CBA.* We consider the quoted text superfluous since Ministry of Finance discloses in its annual public debt reports the CBA loans for which the government provided guarantees (see the respective Annex to annual statements which provides the list of effective loan agreements, which beginning from 2014, is regularly placed onto the MoFinance website), furthermore monthly statistical bulletins identify part of the debt that is guaranteed by the government.

DPI-3 Debt Management Strategy

We disagree with statement under Dimension 1 that *analysis of foreign currency risk is incomplete*. (*In Table 10, the comment that there is no FX risk because debt service payments are less than 10% of CBA foreign assets is incorrect and inconsistent with the subsequent statement that some of these payments need to be hedged*.), as we see no inconsistency between these two statements. Actually, there are no FX risks and the need for future hedging is determined by a different task of reducing the risks for more volatile foreign currencies.

DPI-4 Evaluation of Debt Management Operations

We only partially agree with the statement on the lack of an evaluation of how the government DeM activities have complied with the government's DeM strategy, given that in some cases the evaluation does provide comparison between programmed and actual indicators. Thus, Table 11 of 2012 Annual Public Debt Report provides actual stock of public debt vs. those programmed under 2013-15 MTEF; in Table 14 shares of fixed and floating debt within total debt are reflected and compared with the relevant 2013-15 MTEF debt indicators.

DPI-6 Coordination with Fiscal Policy

In par. 2, we suggest saying that the Department of Budget Process Management (DBPM) is charged with the responsibility of planning the program of borrowings and public debt repayments (repayment of principle and interest payments).

DPI-9 External Borrowing

Report indicates that while *Public Debt Management Department* **(***Revenue Block* should be mentioned instead, see DPI 6, Dimension 1) *prepares yearly borrowing plans for external borrowing, which include projected disbursements from existing and new loans, it is not based on an assessment of the most cost-effective terms.* Note that state budget includes existing and new loan programs, and in this respect, prior to negotiations, PDMD already provides its assessment where the recommended lending terms are summarized (wherever a possibility of different options exists, an attempt is made to choose the option which is the closest to criteria established under the sectoral management strategy), furthermore PDMD recommends payments schedule, calculates Grant Element of a loan, and for loans with floating interest rate evaluates how its change may affect Grant Element. In other words, MoF always assesses costs on servicing debt liabilities. Furthermore, forecasting of costs of servicing foreign borrowings, which should be included in the state budget, is separately carried out for every loan (it is included in the draft state budget as a separate Annex). Forecasts are made under a single scenario (i.e. the same scenario of exchange rates, interest rates and withdrawals is applied). Given that the program of external borrowings of the state budget mostly comprises long-term program loans, it is not feasible to divert a program from its regular path with the view to saving money on interest payments in a particular year. In summary, prior to negotiations, possible loan servicing costs are estimated, and for annual budget calculation of servicing costs is carried out through a single scenario, given that servicing of such loans is carried out by fixed exchange rate. Given that the program of foreign borrowings is determined by the strategic priorities and peculiarities, different scenarios may be applied only for forecasts related to floating exchange rates, which are based on historical flows, expectations available in Bloomberg or Reuters websites, and are of a conservative nature.

DPI-10 Loan Guarantees, On-lending and Derivatives.

Relations pertaining to issuance of central government loan guarantees are regulated under RoA Public Debt Law and Budgetary System Law, while issuance is governed under Government decision nr.380 from 30.06.1998 on approval of issuance of budget guarantees, according to which guarantees are issued subject to Government decision. However, where guarantee is issued to a subject of international law pursuant to RoA Law on International Treaties, relations pertaining to such guarantee are regulated by that law, which naturally prevails over the Government decision. Hence, only in such cases guarantee contract can be approved by National Assembly, provided that it is issued on behalf of the Republic of Armenia. Hence, the procedure on issuance of guarantees does exist, but depending on the subject of guarantee, it is regulated by different legal acts. Therefore, we suggest revisiting assessment of this dimension based on clarification above.

DPI-14 Debt Records

Completeness and timeliness of central government debt records: We suggest updating par. 3 in light of the following information. At present the government foreign guarantees consist solely of those issued against the Central Bank borrowings, part of which was not recorded by DSBOM. However that information was recorded by PDMD, since the latter is responsible for the accounting of CBA external debt, as the latter also maintains the CBA external debt accounting, which is regularly updated on the basis of information received from the Central Bank. That is to say that MoF possesses all information on guarantees issued by the government; therefore government external guarantees have been always recorded and disclosed as an integral part of the RA public debt. Subsequently, MoF in its annual reports on public debt specifies those CBA borrowings for which the government issues guarantees (see the respective Annex to annual statements which provides the list of effective loan agreements, which beginning from 2014, is regularly placed onto the MoFinance website), furthermore monthly statistical bulletins identify part of the debt that is guaranteed by the government.

Annex 2: DeMPA Mission Visit – List of Officials met

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