

# Chapter 2

## The National Bank's activity

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### 2.1. Monetary policy

The main task of monetary policy in 2008 was to create conditions for sustainable economic growth and attainment of the social and economic development targets by attaining monetary objectives and monetary tasks by the instruments of monetary and foreign exchange regulation.

In difficult macroeconomic conditions which were largely due to the widening crisis in the global financial markets which had a negative effect on the Belarusian economy, the primary task of monetary policy, especially in 2008 H2, was to implement a number of measures aimed at minimizing the consequences of the global financial and economic crisis for the financial and credit system of the Republic of Belarus with a view to ensuring stability of the national currency and financial stability as a whole.

The coordinated actions of the Government and the National Bank made it possible to maintain high dynamics of economic growth in the republic and ensure the forecasted level of the Belarusian ruble/the US dollar exchange rate, sustainability of the banking sector, and efficient and secure functioning of the payment system.

#### 2.1.1. Exchange rate policy

In 2008, the monetary policy objective was to protect the Belarusian ruble and assure its stability, including its purchasing power and exchange rate versus foreign currencies. Exchange rate policy played the most important role in the attainment of this objective.

Exchange rate policy in the year under review was geared, above all, to the assurance of the stability of the national currency and was implemented having regard to the tendencies in the global foreign exchange markets and the state of the balance of payments.

In view of the need to respond to the depreciation of the US dollar in the global market and growth of inflation, as well as for the purpose of preventing considerable depreciation of the Belarusian ruble versus the currencies of the main trading partners, the National Bank was gradually strengthening, until August 2008, the exchange rate of the Belarusian ruble versus the US dollar within the limits prescribed by the Guidelines.

In 2008 H2, mutual instability of the exchange rates of foreign currencies in the global markets was increasing under the influence of the financial and economic crisis. In particular, there was considerable strengthening of the US dollar exchange rate and depreciation of the currencies of the main trading partners which could result in the overgrowth of the Belarusian ruble exchange rate versus the currencies of these countries and, therefore, significant worsening of the price conditions of foreign trade.

Given this, the National Bank was gradually depreciating the Belarusian ruble to the lower bound prescribed by the Guidelines (BYR2,200:USD1) with a view to maintaining confidence in the exchange rate policy (Attachment 2.1). In the whole of 2008, the official exchange rate of the Belarusian ruble versus the US dollar dropped by 2.3%, increasing versus the euro and the Russian ruble by 2.8% and 12.2% respectively.

The index of the real exchange rate of the Belarusian ruble versus the Russian ruble, calculated based on the CPI, was below the 2007 level by 1.9%, and the real effective exchange rate by 0.6%.

## 2.1.2. The use of monetary policy instruments

The National Bank used monetary policy instruments to meet the objectives stipulated for 2008 by means of regulation of the refinance rate and interest rates on money market operations (Attachment 2.2).

According to the Guidelines, the refinance rate of the National Bank at the end of 2008 was estimated at the level of 7-9% per annum, inflation being 6-8%.

In 2008 H1, the refinance rate did not change and stood at 10% per annum. However, due to the acceleration of inflation in 2008 H2 the National Bank gradually raised it to 12% per annum in order to increase return on savings in Belarusian rubles and to further encourage households and organizations to deposit funds with banks. In 2008, the above-mentioned rate averaged 10.3% per annum versus 10.5% per annum in 2007. In real terms the refinance rate was negative (minus 2.2% per annum) due to higher inflation rates compared with 2007.

The National Bank was influencing the dynamics of interest rates in the money market and banks' liquidity through operations of three types: standing facilities, bilateral operations, and open market operations.

Interest rates on standing facilities designed to regulate liquidity (overnight credits, overnight swap operations, and banks' deposits with the National Bank) restricted the fluctuations of interest rates in the overnight IRCM. Auction operations in the open market (lombard credit, direct and reverse repo transactions, issue of the National Bank's short-term bonds, and banks' deposits with the National Bank) smoothed the range of yield fluctuations in the IRCM within the band set by the fixed rates (Attachment 2.3).

In 2008 Q1-Q3, money markets were characterized by a significant excess of liquidity. During this period the National Bank focused mainly on the withdrawal of banks' excess liquidity by placing banks' temporary idle funds on an auction basis (in short-term bonds of own issue and deposits, as well as by purchasing Government securities under reversed repo operations) and in the National Bank's deposits at a fixed interest rate. The daily average balance of funds placed by banks with the National Bank amounted in January-September 2008 to 1.05 trillion Belarusian rubles.

The refinancing of banks in January-September 2008 was insignificant. The daily average balance of banks' debt on the National Bank's liquidity support operations amounted to 23.5 billion Belarusian rubles.

Given the existing financial markets conditions, the level of interest rates on standing facilities designed to maintain and withdraw banks' liquidity did not change in January-August 2008 and amounted to 20% and 5% per annum respectively. On September 17, 2008, the interest rates on the above-mentioned operations fell by three percentage points (to 17% per annum).

However, with a view to stabilizing the foreign exchange market, the National Bank was gradually increasing the interest rates in the overnight IRCM since mid-October 2008 by raising interest rates on liquidity support operations in the open market. In October-December 2008, the interest rates on lombard auctions grew from 12% to 18% per annum. In November 2008, the interest rates on standing facilities designed to regulate liquidity were raised by 3 percentage points (from 17% to 20% per annum on overnight credit and overnight swap and from 5% to 8% per annum on overnight deposit) (Attachment 2.4).

In 2008 Q4, unfavorable external economic factors resulted in a significant liquidity deficit in the money markets. For the purpose of ensuring a stable payment process, the National Bank provided banks with considerable resources. The daily average outstanding debt of banks under the operations designed to support current liquidity amounted in October-December 2008 to 1.4 trillion Belarusian rubles. Since some banks lacked the required volume of highly liquid assets used as collateral on these operations, the National Bank started to carry out additional refinancing by granting credits secured by forfeit. The daily average outstanding debt under such credits amounted in the above-mentioned period to 481.7 billion Belarusian rubles.

In 2008, the daily average outstanding debt under standard operations designed to support current liquidity of the banking system amounted to 369.6 billion Belarusian rubles and under operations designed to withdraw liquidity to 807.9 billion Belarusian rubles. The share of auction operations designed to withdraw liquidity in the total volume of sterilizing operations amounted to 72% and of the auction operations designed to support liquidity to 58.6%.

Money supply and banks' current liquidity were regulated by the required reserves mechanism. Compliance with the reserve requirements on an averaged basis enabled banks to minimize short-

term liquidity fluctuations, thereby smoothing the interest rates level in the IRCM. Reserve requirements were the source of overnight liquidity support.

On December 1, 2008, the required reserves ratio for banks and non-bank financial institutions was lowered for the purpose of supporting banks' current liquidity:

- the ratio of required reserves to natural persons' resources attracted in Belarusian rubles from 4.5% to 1.5%;
- the ratio of required reserves to legal persons' resources attracted in Belarusian rubles from 8% to 7%; and
- the ratio of required reserves to resources attracted in foreign exchange from 8% to 7%.

The ratio of the fixed portion of the reserve requirements was lowered from 70% to 60% on December 1, 2008 with a view to facilitating banks' capacity to regulate their liquidity.

### **2.1.3. Monetary indicators**

#### **2.1.3.1. Deposit and credit markets' rates**

The National Bank's interest rate policy was aimed at maintaining interest rates at the level facilitating the availability of credits to the economic entities and attraction of legal and natural persons' funds to bank deposits.

The average interest rate on fresh time deposits and ruble deposits in escrow amounted in 2008 to 11.6% per annum and grew by 0.7 percentage points compared with 2007 owing to a 1.1 percentage points increase (to 13.6% per annum) in the rate on natural persons' deposits and a 1.1 percentage points increase (to 11.3% per annum) in the rate on legal persons' deposits. Such change in the rates on deposits was mainly due to the increase in the refinancing rate. In 2008, the real interest rate on natural persons' fresh ruble time deposits was positive, facilitating the growth of natural persons' savings and expansion of banks' resource base and lending.

The interest rate on fresh time deposits in FCC amounted in 2008 to 7% per annum, growing by 0.4 percentage points compared with 2007. The interest rate on natural persons' fresh time deposits in FCC amounted to 8.8% per annum, growing by 1.3 percentage points compared with 2007, on legal persons' deposits in FCC to 5.8% per annum, dropping by 0.2 percentage points.

The average interest rate on banks' fresh credits in the national currency (excluding credits granted at the expense of credits of the National Bank and Government agencies as well as soft credits granted according to the decision of the President of the Republic of Belarus and the Government) increased by 0.4 percentage points compared with 2007 and stood at 14.1% per annum. Such growth of the interest rate on credits was due to the appreciation of the funds attracted from legal and natural persons. In 2008, the interest rate declined in real terms to 1.6% per annum against 2.2% per annum in 2007. The decline in the real interest rate on credits improved access thereto.

In 2008, the interest rate on banks' fresh credits in FCC increased by 0.1 percentage points compared with 2007, amounting to 11.4% per annum. The growth of the interest rate on credits in FCC was due to the appreciation of funds in the global financial markets.

#### **2.1.3.2. Key monetary indicators**

In the year under review the ruble money supply ( $M2^*$ )<sup>1</sup> rose by 22.5% (by 35% in 2007) due to enterprises' production, investment, and financial activities as well as the changes in the balance of households' money incomes, expenditures, and savings (Attachments 2.5 and 2.6). Its dynamics, especially in 2008 H2, was mainly determined by negative processes caused by the internal factors as well as a worsening situation in the external markets, especially since September 2008.

The rates of ruble money supply growth were characterized by seasonal lowering at the beginning of the year, growth in February-September as a result of business activities expansion, and reduction in October-November 2008, mainly due to the decreased volumes of goods and services sold by organizations in the domestic and external markets, of the share of proceeds paid in monetary funds, slowing growth of bank credits granted to legal and natural persons, as well as the accumulation of the stocks of finished goods and increased demand of organizations and households for foreign exchange. A significant increase in budgetary expenses contributed to the growth of  $M2$  in December 2008 (Attachment 2.7).

<sup>1</sup> Monetary aggregate  $M2^*$  - aggregate  $M2$  plus legal and natural persons' funds in securities (except shares) in Belarusian rubles issued by the National Bank and banks.

The growth of the ruble money supply was due to a 15.4% increase in cash in circulation and a 24.3% increase in its non-cash component, with ruble deposits growing by 28.9%, and the volume of securities issued by banks (outside bank circulation) reducing by 31.7%.

The active ruble money supply (M1) increased by 22.6%, accounting for the major share (52.2%) in the ruble money supply and (along with time deposits and deposits in escrow) around a half of M2\* growth. Transferable deposits of legal persons saw the highest rates of growth (by 32.8%) in the active money supply, accounting for the main share in its growth (61.5%) as well as in its structure (46%).

The dynamics of the active money supply within the year conformed to the changing volumes of legal persons' transferable deposits (Attachment 2.8).

Increasing households' money incomes, retail turnover and paid services, expanding households' settlements by bank cards, declining households' propensity to save by depositing funds, and increasing demand for foreign exchange at the end of 2008 were the main factors that determined the dynamics of cash in circulation and natural persons' transferable deposits.

Time deposits and deposits in escrow were growing at the fastest rates (by 30.4%). Households' ruble savings accounted for their main share (63.4%). In 2008, natural persons' time deposits in Belarusian rubles grew by 13.7% (26.3% in 2007). Their growth rates lowered due to the growing inflationary and devaluation expectations as well as the expectations related to the information on the adverse developments regarding deposit protection in a number of neighboring countries, which gave rise to the outflow of ruble funds into foreign exchange deposits at the end of 2008. At the same time, due to growing interest rates on ruble deposits with maturities exceeding one year the share of the long-term monetary funds in the structure of fresh time deposits and deposits in escrow in Belarusian rubles increased to 46.5% versus 33.8% in 2007.

The average annual ruble money supply in real terms (adjusted for the GDP deflator) increased by 18.2%, with real GDP growing by 10%. The growth in the ruble money supply was accompanied by a more vigorous deceleration of money velocity compared with 2007. The average annual ruble money supply velocity dropped by 6.9% (to 7 circulations) compared with 2.8% (to 7.5 circulations) in 2007.

In the period under review, the economy's monetization calculated on the basis of the average annual ruble money supply increased from 13.4% to 14.4%.

In 2008, there was a slight improvement in the structure of the ruble money supply. The share of time deposits and deposits in escrow grew by 2.7 percentage points (to 44.4%) and transferable deposits by 1.2 percentage points (to 33.5%). The share of cash in circulation fell by 1.1 percentage points (to 18.7%), and securities issued by banks (outside bank circulation) by 2.8 percentage points (to 3.4%) (Attachment 2.9).

Deposits in foreign exchange rose by 30% in the dollar equivalent (by 51.2% in 2007). Time deposits and deposits in escrow grew faster (by 38.6%) than transferable deposits. While households' savings accounted for the main share in the growth (70.4%) and volume (54.2%) of deposits in foreign exchange as a whole, as well as of time deposits and deposits in escrow (88.3% and 79.4% respectively), legal persons' funds accounted for the main share in transferable deposits (103.1% and 96.2% respectively).

The broad money supply grew in 2008 by 26.3% (by 40% in 2007). The average annual broad money supply in real terms (adjusted for the GDP deflator) increased by 18.7%, its average annual velocity decelerating by 7.3% (to 4.7 circulations) compared with its deceleration by 5.4% in 2007 (to 5.1 circulations).

The economy's monetization calculated on the basis of the average annual broad money supply increased from 19.7% to 21.3% in the period under review.

In the broad money supply the ruble share dropped by 2.1 percentage points, amounting, as at January 1, 2009, to 66.3%. The share of deposits in foreign exchange increased by 1.7 percentage points and of securities issued by banks (outside bank circulation) in foreign exchange by 0.4 percentage points (Attachment 2.10).

The major source of broad money supply growth was a 54.7% increase in the banking sector's claims on the economy (including a 70.4% increase in the claims in the national currency and a 25.5% increase in the claims in foreign exchange in the dollar equivalent). Declining net foreign assets of the monetary authorities and the banking sector as well as growing Government deposits in bank accounts had a restraining effect.

The decline in the monetary authorities' net foreign assets by 24% was mainly due to the decrease in the Government funds in accounts with the National Bank by USD741.8 million, the sale

by the National Bank of foreign exchange and precious metals worth USD151.9 million in the domestic foreign exchange market, and an increase in the National Banks' claims on banks by USD7.7 million, with banks' deposits with the National Bank growing by USD189 million. Banks' net foreign assets decreased mainly due to the growth of non-residents' credits.

In 2008, the ruble money supply grew by 0.39 trillion Belarusian rubles (5.7%) owing, for the most part, to the following operations of the National Bank and the Government:

- increasing the National Bank's claims on the economy by 2.23 trillion Belarusian rubles;
- increasing the volume of Government securities in the National Bank's portfolio by 46.8 billion Belarusian rubles;
- increasing Government funds (including funds of budgetary organizations) in accounts with the National Bank by 1.34 trillion Belarusian rubles;
- selling, on a net basis, by the National Bank in the domestic market of foreign exchange and precious metals worth 351.2 billion Belarusian rubles;
- restructuring, in accordance with Resolution of the Council of Ministers of the Republic of Belarus and the National Bank of the Republic of Belarus No. 1014/17 "On Restructuring the Arrears of the Government of the Republic of Belarus under the Credits of the National Bank Attributed to the Domestic Public Debt into Government Long-term Bonds" dated August 25, 2004 (National Register of Legal Acts of the Republic of Belarus, 2004, No. 137, 5/14712), the arrears in the amount of 97.9 billion Belarusian rubles; and
- decreasing the National Bank's expenses pertaining to the discharge of its functions as a central bank by 214.1 billion Belarusian rubles.

The international reserve assets of the Republic of Belarus on the national definition fell in 2008 by 26.6% and reached USD3,662.2 million as at January 1, 2009 (the forecast stipulated in the Guidelines being USD3,580-5,500 million). Their decrease was due to growing negative balance of foreign trade in goods and services, reduction of its financing, as well as the need to maintain a stable exchange rate of the Belarusian ruble in the conditions of increasing demand of organizations and households for foreign exchange in 2008 H2.

## **2.2. Supervision over banks' activities**

In 2008, the National Bank continued to enhance the effectiveness of banking supervision by means of streamlining regulatory framework and developing supervisory instruments.

The primary objectives of further improvement of principles and instruments of banking supervision were bringing them closer to the international standards and following the approaches to the banking regulation and supervision tested by international practice. To this end, the National Bank implemented a number of measures based on the results of the 2007 self-assessment of legislation of the Republic of Belarus and its implementation for compliance with the revised version of the Core Principles for Effective Banking Supervision published by the Basel Committee on Banking Supervision in 2006 (Attachment 2.11).

With a view to liberalizing conditions for attracting foreign investments to the banking sector of the Republic of Belarus the participation (quota) of foreign capital in the Belarusian banking system was raised from 25% to 50%.

Due to the adoption in 2008 of the International Financial Reporting Standards (hereinafter—the "IFRS") as well as with a view to enhancing the efficiency of the banking sector regulation, auditing procedures in banks, non-bank financial organizations, banking groups, and banking holding companies were streamlined by way of formalizing in legislation the requirements that audit organizations and auditors-independent entrepreneurs audit the accuracy of banks' annual financial statements in accordance with the IFRS and, based on its results, prepare an audit opinion in compliance with the international audit standards.

For the purpose of improving the quality of corporate management in banks, the qualification and business reputation requirements to the head and chief accountant of a bank or its branch and their deputies were modified, and the procedure for assessing candidates' compliance with the requirements to these positions was simplified. Banks were granted the right to request the assessment of the appropriateness for the posts of the members of the boards of directors (supervisory boards), banks' executive bodies, and candidates for these posts.

With a view to improving risk management, banks continued to introduce the systems of the assessment and mitigation of individual banking risks. The principles of managing interest rate risk and risks related to the outsourcing in the financial sphere were made available to banks which will make it

possible to create an efficient comprehensive system of interest rate risk management of the trade and banking portfolios as well as to reduce risks when choosing the provider of outsourcing services.

The enactment of the Law of the Republic of Belarus "On Credit Histories" dated November 10, 2008 (National Register of Legal Acts of the Republic of Belarus, 2008, No. 275, 2/1538) contributed to the development of the banking sector's infrastructure. Under the Law, information on the following types of agreements concluded by banks will be included in credit histories beginning August 21, 2009: credit agreements, overdraft lending agreements, loan agreements, pledge agreements, surety agreements, and guarantee agreements.

In order to enhance banks' sustainability and increase their capacity to provide credit support to the economy, the size of the minimum regulatory capital requirement applied to the operating banks which are licensed to attract natural persons' deposits as well as to those banks that claim such right was increased on January 1, 2009 from EUR10 million to EUR25 million, in the equivalent.

The National Bank continued bringing the requirements for provisioning for assets and contingent liabilities exposed to credit risk into line with international standards.

For example, when making provisions to cover potential losses on natural persons' credits banks were authorized to use the portfolio approach along with the currently used individual approach to their classification. Provisioning by the portfolios of homogeneous credits is designed to optimize banks' efforts related to the classification and creation of special reserves on a great number of credits which are homogeneous as to their terms and, consequently, the level of credit risk to a bank.

A requirement was imposed on banks to make provisions for covering potential losses on assets (excluding funds placed on the correspondent accounts with other banks and funds involved in the settlement of transactions with banks) and off-balance operations which are classified under Risk Group I at least once a month and no later than on the last business day of the month under review.

Further streamlining of the procedures for consolidated banking supervision was carried out through the implementation of: the secure functioning requirements with respect to a banking group and a banking holding company whose head organization is a bank; the application of the sectoral method of calculation of the capital adequacy of a banking group or a banking holding company; the modification of approaches to the identification of a banking holding company's insiders; and the expansion of requirements to the information provided by banks as part of consolidated banking supervision. Also, all banks are now required to provide the National Bank with information on the persons who may to significantly affect the decisions taken by banks' governing bodies and persons related thereto.

At the invitation of the National Bank the experts of the World Bank and the International Monetary Fund (IMF) carried out (under FSAP) the external evaluation of the extent to which legislation in the field of banking supervision and its implementation conform to the revised Core Principles for Effective Banking Supervision. The experts noted a significant progress in the streamlining of legislation in the field of banking supervision since the last evaluation (November 2004), the implementation of all recommendations made, and the effectiveness of the planned measures designed to enhance the efficiency of banking supervision in the Republic of Belarus.

In 2008, off-site supervision was focused on the development of a package of supervisory response measures aimed at ensuring banks' secure and liquid functioning, protecting the interests of their creditors and minimizing the frequency of banks' bankruptcies and related costs.

The off-site supervision service monitored on a regular basis banks' compliance with the parameters of development prescribed in the Guidelines and secure functioning requirements. The work aimed at providing banks with equal functioning conditions and ensuring fair competition; tightening documentary supervision as regards analysis of the performance indicators, compliance with secure functioning requirements, early identification of negative trends and crisis situations, and implementation of the entire range of supervisory response measures; as well as implementing consolidated supervision of banks continued.

The National Bank focused primarily on the financial condition of the banks in which the state is planning to retain, at the current stage, a controlling interest (above all, JSC "Belagroprombank" and JSC "JSSB Belarusbank") as well as the banks that are licensed to attract natural persons' deposits and those which claim such right.

In 2008, the National Bank conducted eight comprehensive and two topical inspections of the banks of the Republic of Belarus in which the specialists from other controlling agencies took part along with the National Bank's employees. Special attention was given to the banks which were actively involved in granting credit to households, in particular, to the organization of retail lending,

terms of lending, repayment of credit, and payment of interest, as well as compliance with the National Bank's requirements to the disclosure of information.

The National Bank continued to raise the professional level of its employees involved in banking supervision by means of remote training under the FSI Connect Program of the Financial Stability Institute of the Bank for International Settlements (Switzerland), participation in the national and international seminars and conferences, and sharing experience.

### **2.3. Improvement of banking operations regulation**

In 2008, a number of regulatory legal acts were drafted with a view to streamlining banking operations regulation as regards bringing the procedures for non-cash settlements into line with international practice and creating equal conditions for competition in the banking services market. The above-mentioned acts:

- establish procedures for providing an applicant (borrower) with information about the terms of lending and the size of a comprehensive interest rate for the use of credit;
- determine the methodology of calculation of the comprehensive interest rate for the use of credit;
- specify the procedures for uncontested recovery of funds from payers' accounts based on court judgment;
- provide for the reservation by a bank of credit funds and purpose-oriented use of such funds by the borrower after they have been credited to the borrower's current (settlement) account according to the credit agreement;
- cancel procedures for non-cash settlements by means of payment orders followed by their acceptance due to a high cost and inefficiency of this form of settlements; and
- provide for the recovery, as a matter of priority, of payments towards the repayment of debts on the credits issued against the Government guarantees, as well as the guarantees of the regional executive committees, Minsk City Executive Committee, district and municipal (towns of regional subordination) executive committees, and accruals thereon (Attachment 2.12).

### **2.4. Foreign exchange regulation and foreign exchange control**

Foreign exchange legislation was streamlined in conformity with the existing macroeconomic conditions.

With a view to implementing a number of measures aimed at further liberalization of foreign exchange legislation, enhancing the efficiency of foreign exchange control, and promotion of foreign economic activity, the President of the Republic of Belarus issued Edict No. 178 "On the Procedures for Performing and Exercising Control Over Foreign Trade Operations" dated March 27, 2008 (National Register of Legal Acts of the Republic of Belarus, 2008, No. 80, 1/9574) drafted by the National Bank, whereby:

- control over foreign trade operations carried out by banks and customs authorities was simplified without impairing their efficiency; and
- the National Bank may authorize the extension of the period of time required for the completion of foreign trade operations and, based on control over their fulfillment, carry out foreign exchange regulation.

Approval of a number of regulatory legal acts by the Board of the National Bank contributed to the fulfillment of tasks stipulated in the above-mentioned Edict (Attachment 2.13).

In the year under review, the registration procedure for carrying out foreign exchange operations involving capital movement whereby a resident may grant a non-resident a deferment exceeding 180 days to pay for the exported goods (works, services) or to import goods (works, services) was changed to the notification procedure.

The procedures for carrying out foreign exchange operations involving cash were modified. The maximum permitted amount of cash settlements in Russian rubles between resident and non-resident legal persons under export foreign trade agreements was increased. Norms designed to further reduce the flow of documents between a bank and a client when the latter pays in foreign exchange in cash at the bank's cash desk to be credited to the legal person's account were introduced.

With a view to bringing foreign exchange legislation regulating the procedures for the mandatory sale of foreign exchange in the domestic foreign exchange market into line with individual edicts of the President of the Republic of Belarus approved in 2008 and streamlining them based on the practice of their implementation, the above procedures were amended and modified.

In order to prevent negative effects related to capital outflow in the Republic of Belarus during the global financial crisis from increasing, resident legal persons were forbidden to make advance payments for imports without the National Bank's authorization.

### **2.5. Preventing money laundering and terrorism financing**

Approval of a number of regulatory legal acts regulating the organization of the internal control system at the National Bank, other banks, and non-bank financial institutions contributed to the improvement of legislation in the field of preventing money laundering and terrorism financing.

In 2008, international standards were implemented in the banking system of the Republic of Belarus, which establish:

- general requirements to the classification of clients by risk groups for the purpose of improving internal control in the field of combating money laundering and terrorism financing, as well as to the lists of clients associated with high risk, including politically exposed persons of foreign countries;
- the obligation of banks to take reasonable and available under given circumstances measures to determine the ultimate beneficiary owners; and
- the methods of verification (examination of reliability) of information obtained from clients.

With a view to promoting investment attractiveness of the Republic of Belarus as well as eliminating red tape in the Government agencies' activities with respect to banks, the banking control over the threshold financial operations (households' deposits, settlements between enterprises, credits to the real sector of the economy, operations involving credit cards of natural persons, and interbank operations) whose justification and validity is not challenged was cancelled.

In August 2008, the experts of the Eurasian Group tasked with preventing money laundering and terrorism financing made a positive, on the whole, evaluation of the conformity of the system of preventing money laundering and terrorism financing established in the banking sector of the Republic of Belarus to the international standards.

### **2.6. Improvement of accounting and reporting**

In 2008, the National Bank continued to bring the national accounting system into line with the International Accounting Standards (hereinafter—the "IASs"). The National Accounting Standards (hereinafter—the "NASs") and the rules and principles of compilation of the reliable accounting and reporting were improved and the requirements to the volume, quality, and frequency of information to be published were tightened (Attachment 2.14).

In improving the accounting and reporting procedures, the National Bank placed particular emphasis on the enhancement of professional training of the banking system's employees, explanation of theoretical aspects, and teaching of practical skills in applying the IASs and NASs by means of topical seminars.

As part of the above-mentioned work the National Bank obtained advice from international audit organizations on the IASs implementation at the National Bank and the banks of the country.

### **2.7. Cash circulation**

In 2008, the work aimed at creating favorable conditions for cash circulation organization and streamlining its methodological basis was underway (Attachment 2.15).

Cash circulation amounted to 143.58 trillion Belarusian rubles and grew by 31.1 trillion Belarusian rubles (by 27.7%) compared with 2007.

The issue of cash amounted to 0.5 trillion Belarusian rubles remaining at the 2007 level, while the share of cash issue in cash expenditures shrank by 0.1 percentage points, amounting to 0.7% as at January 1, 2009 (the lowest since 1991). Though the volume of cash in circulation grew by 15.4%, decelerating rates of its growth have been observed in recent years.

539.6 million banknotes worth 3.8 trillion Belarusian rubles were in circulation as at January 1, 2009. In the period under review, the amount of banknotes of the National Bank, designed in 2000, grew by 0.5 trillion Belarusian rubles (by 15.1%).

In terms of amount, 100,000-ruble notes accounted, as at the beginning of 2009, for the largest share (40.8%) of the National Bank banknotes in circulation. 50,000-ruble notes, 20,000-ruble notes, 10,000-ruble notes, and 5,000-ruble notes accounted for 38.2%, 12.2%, 5.4%, and 1.9%, respectively, of the total amount of the National Bank banknotes in circulation. Banknotes in lower denominations accounted for 1.5% (Attachment 2.16).

The amount of 100,000-ruble notes in circulation grew by 59.2% compared with 2007, 1,000-ruble notes by 36.4%, 500-ruble notes by 15.4%, 100-ruble notes by 30.8%, 50-ruble notes by 15.4%, 20-ruble notes by 15.4%, and 10-ruble notes by 15.4%. The amount of 20,000-ruble notes, 10,000-ruble notes, and 5,000-ruble notes declined by 8.6%, 10.8%, and 12.5% respectively. The amount of 50,000-ruble notes did not change.

In the year under review, the National Bank fully satisfied the demand of the republic for cash.

## **2.8. Payment system**

In 2008, the National Bank ensured efficient, sound, and secure operation and development of the payment system which was an important precondition of financial stability in the Republic of Belarus.

The automated system of interbank settlements (hereinafter—the “ASIS”) acts as the core component of the payment system while the National Bank, banks, and non-bank financial institutions are participants thereof.

Over 57.8 million payments worth 767.55 trillion Belarusian rubles were effected in the ASIS, of which 23.6 million payments (40.8% of the total number of payments in the ASIS) worth 758.4 trillion Belarusian rubles (98.8% of the total value of payments) in the BISS (the Belarusian Interbank Settlement System) and 34.2 million payments (59.2%) worth 9.15 trillion Belarusian rubles (1.2%) in the clearing system respectively (Attachments 2.17 and 2.18).

Compared with 2007, payments in the ASIS increased by 9.8% in terms of their number and by 50.5% in terms of their value. The average daily turnover amounted to 3.02 trillion Belarusian rubles in terms of their value and to 227.6 thousand in terms of their number.

In the year under review, unauthorized access to the payment system was prevented from happening. As at January 1, 2009, the average annual parameter of banks’ accessibility to the ASIS was 99.95% of the daily production time against 99.5% stipulated by the Guidelines.

The National Bank, in concert with banks, implemented a package of measures designed to increase the use of bank cards in the non-cash payment cycle and to develop the software and hardware infrastructure for their servicing.

About 6.1 million bank cards of international and domestic settlement systems were circulating as at January 1, 2009, up by 26.1% from early 2008. 2,452 ATMs and 2,083 information infokiosks were installed; while trading (servicing) organizations were equipped with 13,608 payment terminals, a 21%, 53.2%, and 47.8% increase respectively, compared with 2007.

By the beginning of 2009, the share of non-cash operations (in Belarusian rubles) in the total volume of operations involving bank cards was 41% in terms of their number and 9% in terms of their value (36.9% and 6.9% respectively, as at January 1, 2008).

Further streamlining of the regulatory framework of the payment system continued (Attachment 2.19).

## **2.9. IT development**

Over 2008, the development of information technologies was aimed at enhancing the performance efficiency of the National Bank and banks.

With a view to improving the system of non-cash and cash settlements in the Republic of Belarus the creation of a single settlement and information space (hereinafter—the “SSIS”) intended for payment of services through banks, non-bank financial institutions, as well as mail and electrical communication organizations continued.

The SSIS would make it possible to implement, on the national scale, required social, preferential, and other settlement schemes as well as to cover a broader spectrum of information and technological solutions when performing banking services for households. At present, agreements on the acceptance of payments through the SSIS are concluded with 22 banks and over 130 service providers in large cities and settlements which have a population of more than 50,000. The SSIS development would make it possible to expand the list of potential instruments for payment by households for the services provided and to connect a wide range of service providers to the system.

The automated system for providing and receiving information on credits became operational in August 2008. This system ensures, on the basis of a single legal, methodological, and information space, all-round automation of the processes designed to provide, process, store, and receive information on the conclusion of credit agreements between the borrowers (natural and legal persons) and banks as well as control of the discharge of obligations under such credit transactions.

In the year under review, the National Bank was developing other components of its information system as well.

## **2.10. International cooperation**

In 2008, the National Bank carried on, pursuant to the Agreement on the Establishment of the Union State, integrating the banking systems of the Republic of Belarus and the Russian Federation. The National Bank of the Republic of Belarus and the Central Bank of the Russian Federation held two meetings of the Interbank Currency Board where measures designed to ensure further harmonization of their monetary policy principles, instruments, and mechanisms were taken. Given current global economic situation, issues relating to the expansion of the use of the Russian ruble in the settlements between legal and natural persons of both countries were discussed at the meetings of the Board. The Agreement on Expanding the Use of the Russian Ruble in the Settlements between Economic Entities of the Republic of Belarus and the Russian Federation was drafted and proposals on the ways of minimizing the consequences of the financial crisis, improving the balance of payments, and developing the environment for entrepreneurial activities and mutual trade were included in the Joint Action Plan of the Governments of Both States.

The top management of the National Bank held meetings with the representatives of the major Russian banks (Savings Bank of Russia, JSC VTB Bank, Vnesheconombank, and others) to discuss the attraction of investments in the banking sector of the Republic of Belarus.

The fulfillment of the Action Plan to Implement the Concept of Cooperation of the Eurasian Economic Community (hereinafter—the “EurAsEC”) Member States in the Foreign Exchange Sphere was addressed at the meeting of the Council of Heads of the Central (National) Banks of the EurAsEC Member States held in September 2008 in Minsk as part of the EurAsEC activities. The Program of Professional Training of the Employees of the Central (National) Banks of the EurAsEC Member States for 2009 was approved.

The National Bank and relevant ministries of the Republic of Belarus in concert with the central (national) banks and ministries of the EurAsEC member states proposed the EurAsEC Member States’ Joint Measures aimed at dealing with the aftermath of the global financial crisis which were approved by the EurAsEC Interstate Council (at the level of Heads of Governments) held on December 12, 2008, and drafted a plan for implementing same.

The Advisory Board of the Central Banks of the Republic of Belarus and Ukraine and the corresponding interbank working group focused on the conditions of interaction between banks of both states in the sphere of payment and settlement as well as foreign exchange transactions. The representatives of the national banks signed the Program to Develop Bilateral Cooperation between the Brest Region Main Department of the National Bank of the Republic of Belarus and the Volyn Region Department of the National Bank of Ukraine.

To ensure smooth mutual settlements between economic entities of both states, the National Bank of the Republic of Belarus drafted amendments to the Memorandum between the Government of the Republic of Belarus and the National Bank of the Republic of Belarus, on the one hand, and the Cabinet of Ministers of Ukraine and the National Bank of Ukraine, on the other, on the Development of a System of Measures Aimed at Intensifying Bilateral Trade and Economic Cooperation at the Time of the Global Financial and Economic Crisis which was signed in January 2009 and submitted them to the Ministry of Foreign Affairs of the Republic of Belarus.

The Law of the Republic of Belarus “On the Accession of the Republic of Belarus to the Agreement on the Establishment of the Eurasian Development Bank” (National Register of Legal Acts of the Republic of Belarus, 2008, No. 159, 2/1457) was passed on June 23, 2008, for the purpose of attracting foreign investments and creating favorable conditions for financing the most important investment projects.

In December 2008, the Council of the Eurasian Development Bank decided to include the Republic of Belarus, the Republic of Armenia, and the Republic of Tajikistan in the membership of said bank.

The National Bank’s cooperation with the international financial institutions contributed to further improvements in the approaches to monetary regulation, sustainability of the banking system, as well as the attraction of foreign financial resources to the banking sector of the Republic of Belarus.

For example, the National Bank developed, in consort with the IMF technical missions, approaches to procedures for managing banks’ credit risk, the development of a system for macroeconomic stress testing and the preparation of the report on financial stability and monetary

policy, and pegging the Belarusian ruble to the currency basket which are used to draw up regulatory legal acts of the National Bank of the Republic of Belarus in the corresponding areas.

Following the talks held in October-December 2008 by the Government and the National Bank of the Republic of Belarus with experts of the IMF missions on the preparation of a Stand By Arrangement using exceptional access and emergency financing procedures, the Executive Board of the IMF approved in January 2009 the extension of a 15 months stabilization loan in the amount of nearly USD2.5 billion to the Republic of Belarus.

Owing to cooperation with experts of the International Financial Corporation and measures taken by the Government and the National Bank of the Republic of Belarus aimed at improving business environment our country was singled out in the World Bank's *Doing Business 2009* as one of the leading reformers of the year 2008, outstripping 30 countries and placing 85th.

In 2008, the EBRD's project to set up a bank specializing in lending to small and medium-sized businesses (CJSC "Belarusian Bank for Small Business") was completed.

The top management of the National Bank held meetings with the representatives of some foreign banks and financial institutions discussing the issues of their participation in the authorized capital of Belarusian banks and opening credit lines for the banking system of the Republic of Belarus. The upshot was that three new banks with prevailing participation of foreign capital were registered in our country in 2008. The share of foreign investments in the aggregate authorized capital of Belarusian banks almost doubled, amounting to 16.96% as at January 1, 2009.

### **2.11. Staffing and staff training**

The reserve of replacements for managers and chief accountants received training as part of the National Bank's and banks' staff management system operation. All newly appointed managers, deputy managers, and chief accountants went through the mandatory certification procedure at the National Bank.

The implementation of public policy on human resources management made it possible to ensure high personal and professional potential of the National Bank's employees. As at January 1, 2009, 84.9% of the total number of managers and specialists were graduates of the institutions of higher education (93.8% in the main office), of which 31 person (1.4%) had a PhD and 59 persons (2.7%) held a Master's degree.

As regards employees' training and skills upgrading, special emphasis was placed on improving the quality of education, learning domestic and foreign banking experience, and expanding contacts with the EurAsEC and CIS member states in the field of training.

In 2008, the Training Center of the National Bank was the main facility for raising skills of 1,200 employees of the National Bank as well as of 695 managers and experts of Belarusian banks. In the year under review, 36 persons received occupational retraining at the training centers of the country.

Also, 92 persons attended international seminars and special-purpose programs to study the best practices of foreign central banks and to raise their skills. 110 employees of the National Bank underwent training and on-the-job training in the EurAsEC member countries.

### **2.12. Internal audit**

In 2008, the organizational units and organizations of the National Bank were audited, cash and other valuables were inspected, their safekeeping in the custody of vaults of all organizational units of the National Bank was examined, and topical examinations of the operations performed by the organizational units of the main office were conducted. The frequency of examinations stipulated in paragraphs 91 and 92 of the Statute of the National Bank of the Republic of Belarus approved by Edict of the President of the Republic of Belarus No. 320 dated June 13, 2001 (National Register of Legal Acts of the Republic of Belarus, 2001, No. 58, 1/2748) was ensured.

Based on the results of examinations and inspections, the remedial actions were taken which were conducive to the tightening of internal control and minimizing the after-effects of risks and probability of their manifestations in carrying out operations by the National Bank.

The operation of subsystems and software complexes of the National Bank's information system was audited.

Issues of ensuring security of the systems crucial, above all, to the National Bank, were top priority in auditing information technologies. In compliance with the requirements of the international standards, risks were analyzed and assessed on the basis of the audit results of information system components and also recommendations for the mitigation and elimination thereof were made.

A mandatory annual audit of activities of the National Bank as an agency involved in certifying computer-based tools in the sphere of banking services and technologies (accreditation certificate BY/112 01.1.0.0086 dated April 5, 2005, issued by the State Committee on Standardization) was carried out.

### **2.13. Improving banking legislation**

In 2008, the National Bank's legislative activity was aimed at improving banking law on regulation of banking operations, credit and pledge relations, protection of bank deposits, foreign exchange operations, and other fields of banking. The National Bank was active in promoting the liberalization of business environment in the Republic of Belarus.

The National Bank was directly involved in drafting the following legislative acts which became law in the year under review:

- the Law of the Republic of Belarus "On Guaranteeing Repayment of Bank Deposits of Natural Persons" dated July 8, 2008 (National Register of Legal Acts of the Republic of Belarus, 2008, No. 172, 2/1466) which lays a legal groundwork for the protection of natural persons' monetary funds placed in accounts and/or deposits with banks of the Republic of Belarus against potential failures of the banks; and

- the Law of the Republic of Belarus "On Credit Histories" dated November 10, 2008, which regulates relations involving the compilation of credit histories by the National Bank based on information about credit transactions presented by the sources of credit histories and the provision of credit reports by the National Bank to the users and subjects of credit histories.

In 2008, the Board of the National Bank of the Republic of Belarus approved 80 resolutions and the Board of Directors of the National Bank of the Republic of Belarus approved 51 resolution dealing with various fields of activities of the Belarusian banking system.