Black Sea Region:

Sources of Sustainable Growth

Black Sea Trade & Development Bank

Annual Report 2012

Contents

Board of Governors

As of 31 December 2012

Republic of Albania	
Governor:	Mr. Nezir HALDEDA, Deputy Minister of Finance
Alternate Governor:	position vacant
Republic of Armenia	
Governor:	Mr. Arthur JAVADYAN, Chairman, Central Bank of Armenia
Alternate Governor:	Mr. Vahe VARDANYAN, Director, Financial System Stability & Development Department, Central Bank of Armenia
Republic of Azerbaijan	
Governor:	Mr. Samir SHARIFOV, Minister of Finance
Alternate Governor:	Mr. Shahin MUSTAFAYEV, Minister of Economic Development
Republic of Bulgaria	
Governor:	Ms. Boryana PENCHEVA, Deputy Minister of Finance
Alternate Governor:	Ms. Jenya DINKOVA, Director, International Financial Institutions & Cooperation Directorate, Ministry of Finance
Georgia	
Governor:	Mr. George KADAGIDZE, President, National Bank of Georgia
Alternate Governor:	Mr. Nodar KHADURI, Minister of Finance
Hellenic Republic	
Governor:	Mr. Notis MITARACHI, Deputy Minister of Development, Ministry for Development, Competitiveness, Infrastructure, Transport & Networks
Alternate Governor:	Mr. Christos GEROULANOS, Desk Officer for European & International Affairs of the Competitiveness Advancement Directorate, Ministry for Development, Competitiveness, Infrastructure, Transport & Networks
Republic of Moldova	
Governor:	Mr. Veaceslav NEGRUTA, Minister of Finance
Alternate Governor:	position vacant
Romania	
Governor:	Mr. Florin GEORGESCU, Vice Prime Minister & Minister of Public Finance
Alternate Governor:	Mr. Claudiu DOLTU, Secretary of State, Ministry of Public Finance
Russian Federation	
Governor:	Mr. Sergey STORCHAK, Deputy Minister of Finance
Alternate Governor:	Mr. Sergey BELYAKOV, Deputy Minister of Economic Development
Republic of Turkey	
Governor:	Mr. Ibrahim H. CANAKCI, Undersecretary of Treasury, Undersecretariat of Treasury
Alternate Governor:	Mr. Cavit DAGDAS, Deputy Undersecretary of Treasury, Undersecretariat of Treasury
Ukraine	
Governor:	Mr. Petro POROSHENKO, Minister of Economic Development & Trade
Alternate Governor:	position vacant

Board of Directors

As of 31 December 2012

Republic of Albania

Director: position vacant

Alternate Director: Mr. Altjon PALOKA, Director of Borrowing, General Debt Management Directorate, Ministry of Finance

Republic of Armenia

Director: Mr. Vardan ARAMYAN, Deputy Minister of Finance

Alternate Director: Mr. Nerses MKRTCHIAN, Director, Multilateral & Bilateral Economic Cooperation Department, Ministry of Foreign Affairs

Republic of Azerbaijan

Director: Mr. Mikayil JABBAROV, Director, Administration of State Historical Architectural Reserve "Icherisheher", Cabinet of Ministers of the Republic of Azerbaijan

Alternate Director: Mr. Famil ISMAYILOV, Deputy Head, International Relations Department, Ministry of Finance

Republic of Bulgaria

Director: Ms. Milena BOIKOVA, Director, Government Debt & Financial Markets Directorate, Ministry of Finance

Alternate Director: Mr. Nikola SHERLETOV, Parliamentary Secretary, Ministry of Finance

Georgia

Director: Mr. David LEZHAVA, Deputy Minister of Finance

Alternate Director: Mr. David EBRALIDZE, Deputy Minister of Finance

Hellenic Republic

Director: Mr. Serafeim TSOKAS, Secretary General, Ministry for Development, Competitiveness, Infrastructure, Transport & Networks

Alternate Director: Mr. Petros KONTOS, Director, International Economic Organizations Directorate, Ministry for Development, Competitiveness, Infrastructure, Transport & Networks

Republic of Moldova

Director: Ms. Elena MATVEEVA, Director, Public Debt Department, Ministry of Finance

Alternate Director: Ms. Ina GOREA, On-Lending Directorate, Public Debt Department, Ministry of Finance

Romania

Director: Ms. Diana PELIGRAD BLINDU, Head Operations I, General Directorate for Treasury & Public Debt, Ministry of Public Finance

Alternate Director: Mr. Stefan PETRESCU, Head of Operation Division, External Public Finance, Ministry of Public Finance

Russian Federation

Director: Mr. Alexander GORBAN, Director, Economic Cooperation Department, Ministry of Foreign Affairs

Alternate Director: position vacant

Republic of Turkey

Director: Mr. Evren DILEKLI, Acting Director General, General Directorate for Foreign Economic Relations, Undersecretariat of Treasury

Alternate Director: position vacant

Ukraine

Director: Mr. Valeriy PYATNYTSKIY, Commissioner for European Integration

Alternate Director: Mr. Serhiy RYBAK, Deputy Minister of Finance

Audit Committee

As of 31 December 2012

Ms. Milena Boikova, Director for the Republic of Bulgaria & Chairperson of the Audit Committee;

Ms. Elena Matveeva, Director for the Republic of Moldova and Audit Committee member;

Mr. Altjon Paloka, Alternate Director for the Republic of Albania and Audit Committee member;

Mr. Vardan Aramyan, Director for the Republic of Armenia and Audit Committee member

Management

As of 31 December 2012

Vitalii Mygashko
Vice President
Operations

Valentina Siclovan
Vice President
Finance

Andrey Kondakov
President

Chairman of the
Board of Directors

Orsalia Kalantzopoulos
Secretary General

Mustafa Boran
Vice President
Banking

To the Board of Governors

In accordance with Article 35 of the Agreement Establishing the Black Sea Trade and Development Bank and Section 10 of its By-Laws, I submit to the Board of Governors the Bank's Annual Report for 2012 as endorsed by the Board of Directors. The Fourteenth Annual Report contains the Bank's financial statements; separate financial statements for the operations of the Bank's Special Funds have also been issued, as prescribed in Section 12 of the Bank's By-Laws.

Andrey Kondakov

Chairman of the Board of Directors

President

Black Sea Trade and Development Bank

Statement by the President

Following a pattern that lately has become all too familiar, the global economy in 2012 was characterized by uncertainty, with an ebb and flow of crises and market volatility which have taken their toll on stability and growth. As a neighbor to the European Union, which was beset by the Eurozone crisis particularly in the first half of the year, the Black Sea region was inevitably affected by contagion from that crisis as well as the fear of further spillover effects emanating from Western Europe. This only added to the array of everyday challenges faced by the region's economies as they seek to consolidate the reforms of previous years, and to secure stability in order to lay the basis for sustained economic development.

Impressively, most of the countries of the Black Sea Economic Cooperation (BSEC) achieved positive, albeit lower, rates of economic growth. As a whole, real regional GDP growth averaged 2.1 percent in 2012, demonstrating once again the resilience of the region's economies in the face of unfavorable external conditions. The growth was underpinned by stable and improving macroeconomic indicators – historically low inflation, declining fiscal deficits, better current account balances, generally low levels of public debt, stable financial sectors, and a business environment which continued its impressive momentum of reform and progress.

Once again, countries from the Black Sea region featured prominently among the best performers in the various publications devoted to the measurement of business environment, such as the World Bank's Doing Business Report. Taken alongside the resolve and flexibility that have become hallmarks of the firms and banks that operate in the Black Sea region, this highlights the improving competitiveness of the region and its favorable prospects.

The Black Sea Trade and Development Bank has sought to work with such dynamic firms and financial institutions, to help them expand, modernize, and fulfill their potential, thus creating wealth and new jobs for the benefit of the region's economies. The Bank is particularly proud of its role in two areas. First, the growing portfolio of small and medium enterprise operations, which provides targeted assistance to those firms that need financial, networking, and informational support and often represent the most vigorous and energetic sector of the economy. Second, regionally based firms which invest in other member countries, helping to provide finance and risk mitigation services to companies which expand their market coverage, provide new services and products to customers in the market in which they have invested, and promote regional cooperation in a mutually beneficial manner for the investor and for the local economy.

In 2012, the BSTDB Board of Directors approved 16 new operations for EUR 161.2 million, and 15 operations amounting to EUR 168.0 million were signed. These figures represent a slowdown relative to 2011, as the Bank adopted a more cautious outlook to new operational development in light of heightened uncertainties. Priority was given to consolidation and ensuring that operations approved and signed in previous years completed their cycle through to disbursement. Indeed, disbursements (including rollovers and renewals) increased by nearly ten percent to EUR 224.0 million for the year. At year end, the Bank's outstanding portfolio had grown to EUR 785.9 million, up 9.1 percent compared to end 2011.

Significantly, for the eighth consecutive year the Bank registered positive net income in 2012. Relative to 2011, it increased 48.4 percent to EUR 14.9 million. The Bank also maintained the good quality of its operational portfolio and focused on stabilizing the level of problem projects.

The challenging situation in markets prompted the Bank to revise its Medium Term Strategy and Business Plan (MTSBP) for the 2011–2014 period. After thorough review of the document, the BSTDB Board of Governors opted for a more careful approach targeting annual growth to the order of 7–7.5 percent, which is roughly the historical average growth rate of the Bank, until conditions permit more rapid expansion closer to the original base case scenario.

Externally, the Bank maintained its active stance, participating in and contributing to various forums of development banks that discuss issues of common interest, including harmonization of procedures and indicators, enhancing risk management techniques, promoting important developmental agendas and expanding the scope and depth of information sharing.

In 2012, the Bank updated its human resources policies in line with prevailing best practices. It also finalized the first phase of the automation of its operational cycle within the SAP system, improving the structuring of data and reporting, the securing of data integrity, and the sharing of information across systems. The BSTDB also completed its secured vital records management system, moved vital records to a secure offsite storage facility, updated its business continuity processes, initiated implementation of a new and enhanced disaster recovery site, and upgraded virtual infrastructure as well as the security software to secure remote access to Bank systems.

BSTDB is committed to the pursuit of its strategy of managed operational expansion in order to meet the growing demand from regional firms, banks, and agencies while also undertaking additional activities that promote the Black Sea region, increasing awareness and interest. The underlying driving objective is the creation of added added for the Bank's shareholders, and the contribution to the founding vision of the institution to promote economic development and regional cooperation.

Andrey Kondakov

Chairman of the Board of Directors
President
Black Sea Trade and Development Bank

Highlights of 2012

- The BSTDB Board of Directors approved 16 new operations for EUR 161.2 million, and 15 operations amounting to EUR 168.0 million were signed.

  Disbursements increased by nearly ten percent to EUR 224.0 for the year[1]. At year end, the Bank's outstanding portfolio had grown to EUR 785.9 million, up 9.1 percent compared to end 2011.

  The Bank registered positive net income in 2012 for the eighth consecutive year. It increased 48.4 percent over the previous year, to EUR 14.9 million.

- In August 2012, Moody's and Standard & Poor's reaffirmed their long-term and short-term credit ratings of BSTDB, at A3/P-2 and A/A-1 respectively, both with stable outlook. BSTDB remained the best-rated financial institution in the Black Sea region and one of the top-rated in Central and Eastern Europe.

- In September 2012, the Bank issued its debut Swiss Franc (CHF) bond. The CHF 200 million, four-year unsecured bond with a coupon of 2.5% had Credit Suisse as sole arranger and attracted more than 50 investors, including asset managers, private banks, and retail clients. The proceeds of the issuance are assisting BSTDB in responding to the funding needs of its clients in the Bank's member countries.

- BSTDB continued to expand its cooperation with other partners in development to facilitate knowledge sharing aimed at increasing developmental effectiveness. In 2012, in Thessaloniki, BSTDB hosted annual meetings of the European Chief Compliance Officers of European International Financial Institutions and of the Chief Legal Officers of sixteen leading IFIs, as well as an international seminar of the IFIs Evaluation Cooperation Group on post evaluation systems. The Bank has also contributed to the IFIs meetings of the Heads of Procurement, the Development Financial Institutions Corporate Governance Working Group and Independent Accountability Mechanisms, and to the meetings of IFI Board Secretaries.

- A joint report "International Finance Institutions and Development through the Private Sector" produced by 31 development institutions, was presented and discussed at the Business Forum hosted by the Bank on the occasion of its 14th Annual Meeting in Yerevan, Armenia. The report highlighted the significant role IFIs play in catalyzing private sector involvement by encouraging entrepreneurial initiatives that help growth and job creation.

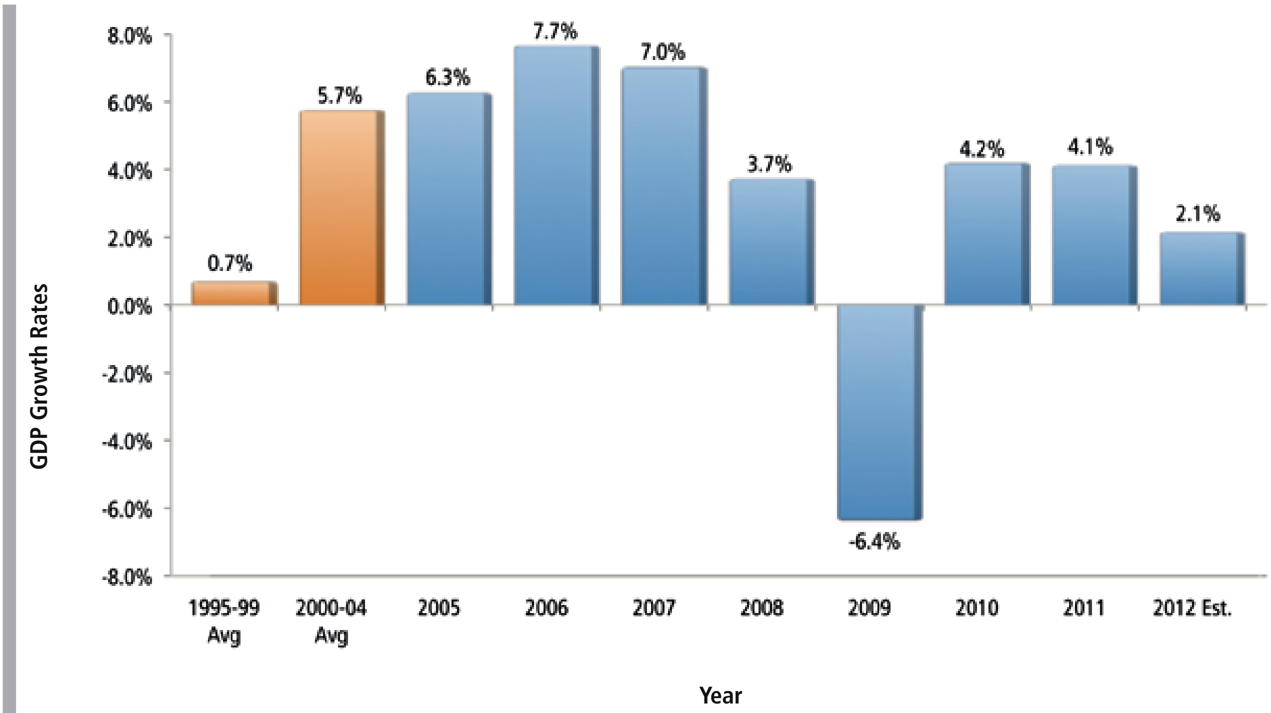
1 As calculated using the 2012 year-end Euro exchange rates.

Economic Developments in the Black Sea Region during 2012[2]

Economic Overview of 2012 in the Black Sea Region

Economic growth in the Black Sea region slowed in 2012, relative to the outturns of the two previous years. As Figure 1 shows, the region's average real GDP growth in 2012 was an estimated 2.1%, roughly half the levels of growth achieved in 2010 and 2011. To some extent, this slowdown is disappointing, since the rates achieved in the previous years had seemed to imply that the region had put behind it the short but severe recession that resulted in the aftermath of the global financial crisis in September 2008 and led to a 6.4% contraction of GDP in 2009, among the highest in the world.

Figure 1: Black Sea Region Average Annual Real GDP Growth



Source: National Statistical Agencies & IMF–IFS

2 Note on Sources: Black Sea Region data based on BSTDB calculations from National Statistical Agencies of the countries of the Black Sea Region and the International Monetary Fund IFS Database. Additional sources referred to include *Global Economic Prospects 2013* of the World Bank (as well as earlier GEPs), the IMF's *World Economic Outlook* publications (and their updates) and the Economist Intelligence Unit. As many figures at the time of writing represent estimates for 2012, actual final figures may differ in detail, but the overall trends discussed in this section will not be altered.

At first glance, it suggests that the more robust growth of the previous two years was due to recovery from the recession, and once this was achieved, growth slipped back to a mediocre post-crisis trend. Since the Black Sea region is largely composed of middle income countries, weak growth means that convergence to the higher income levels and living standards of Western Europe becomes more difficult to achieve.

A second, closer look at the region reveals a more nuanced picture. The Black Sea region's 2.1% real GDP growth was achieved despite declines in agricultural production in most countries. While agriculture's share of GDP formation has generally declined over time, it remains a vital sector but also one which is prone to sizeable year-on-year fluctuations, vulnerable to exogenous factors. After a bumper year in 2011, poor weather in 2012 – chiefly drought – affected agricultural production in most of the region negatively and put downward pressure on GDP output figures. By comparison, growth in services – including construction – and in industrial production was softer than in 2010 or 2011, but generally in positive territory and more stable than agriculture.

Weighed against other regions, the picture was mixed. Relative to key emerging market regions such as East Asia (7.5% GDP growth), South Asia (5.4%), Latin America (3.0%), or the Middle East and North Africa (3.8%), the Black Sea region's growth was much lower. However, the Black Sea region outperformed the entire European Union (EU) which suffered a contraction of approximately 0.5%, including the Eurozone, which shrank by 0.3% overall, as well as the eight Central European and Baltic countries[3] – the "CEE & Baltics" that joined the EU in 2004 and, as former "transition" countries, are often compared to the countries of the greater Black Sea region – which grew at an anemic 0.9%.

The Eurozone's recession, and its continuing problems emanating from the debt crisis which spilled across borders, are the key reasons for the softness of growth in the Black Sea region. The EU, and more specifically the Eurozone area, is by far the most significant economic partner of the member countries of the Black Sea region. EU members are the most significant trade partners of most Black Sea Economic Cooperation (BSEC) member countries, and they are also the principal source of financing and foreign direct investment.

Economic downturns in the EU result in reduced demand for Black Sea exporters. The Eurozone crisis – which peaked in mid-2012 and subsequently subsided although at end 2012 was by no means over – impacted negatively the risk appetite of EU based financiers and potential investors, thus resulting in reduced interest (and ability) to undertake investment or provide other forms of financing to the Black Sea region. Put differently, high levels of uncertainty in the Eurozone spilled over into the Black Sea region and were key contributing factors to forestalled investment and consumption.

The EU effect becomes more obvious when looking at the outturns of individual BSEC countries (see Table 1). Continuing a trend observed in 2010 and 2011, countries in the western part of the Black Sea region as a rule fared worse than countries in the eastern part of the Black Sea region. The western countries, of course, are closer geographically to the EU and they are also more tightly intertwined institutionally – with three Black Sea countries also being members of the EU – as well as economically, with a larger share of their external trade going to/coming from the EU, greater ownership of domestic financial institutions by EU based banks, and tighter financing and investment links. The negative spillover is higher in the western part of the Black Sea region relative to the eastern part, and this is readily observed in individual country GDP figures.

Growth rates showed considerable variation among countries, but only two countries, Armenia and Georgia, achieved high rates of real GDP growth in excess of 5%. Three states posted moderate growth of between 2–5%, four states registered low growth of less than 2%, and three states experienced contractions, in real terms. Nine out of the twelve BSEC countries posted lower GDP rates in 2012, relative to 2011, consistent with the overall climate of weaker growth. In three cases, the observed drops in growth were significant, exceeding 5%.

3 Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia.

Table 1: Summary of Key Economic Indicators for 2012, by BSEC Member Country

	GDP Growth	Inflation	Cur Acct Bal / GDP	Budget / GDP	Public Debt / GDP	FDI / GDP
Albania	1.1%	2.0%	-11.7%	-3.4%	60.9%	6.5%
Armenia	7.2%	2.6%	-8.4%	-1.5%	44.2%	5.4%
Azerbaijan	2.2%	1.1%	21.7%	0.3%	12.6%	1.2%
Bulgaria	0.8%	3.0%	-1.3%	-0.8%	18.5%	3.7%
Georgia	6.1%	-0.9%	-11.5%	-2.9%	34.9%	5.5%
Greece	-6.4%	1.5%	-2.9%	-6.6%	157.5%	0.2%
Moldova	-0.8%	4.6%	-7.0%	-2.5%	28.3%	2.2%
Romania	0.2%	3.3%	-3.8%	-2.5%	34.6%	1.2%
Russia	3.4%	5.1%	3.7%	0.4%	11.5%	2.6%
Serbia	-1.7%	7.8%	-10.6%	-6.4%	44.5%	0.9%
Turkey	2.2%	8.9%	-6.0%	-2.0%	36.1%	1.6%
Ukraine	0.2%	0.6%	-8.4%	-3.3%	34.7%	4.4%

Sources: National Statistical Agencies

On the expenditure side, in most countries, private consumption was the main contributing source of positive growth. Government consumption was generally down, as governments persisted with long running efforts to improve their fiscal position and reduce outstanding debt, both of which expanded during the economic downturn of 2009 when revenues had fallen sharply. Weaker economic growth meant that revenue projections became more uncertain, and this in turn necessitated reductions in spending in order to maintain, or avoid deterioration in fiscal balances. Investment growth was also weak in comparison with 2011, primarily due to the prevailing climate of uncertainty – which always has a dampening effect on investment.

The principal exceptions to this trend were the energy rich states, which draw a large share of government revenues from the extraction and sale of oil and gas and have enjoyed windfalls from high energy prices in recent years. Notwithstanding the rising dependence of budget revenues upon energy prices (which are volatile and therefore prone to sharp adjustments upwards and downwards), the energy rich countries enjoyed a more robust fiscal position relative to the regional countries without significant energy resources, and they recycled a larger share of those earnings, mainly in the form of rising public salaries and higher public investments.

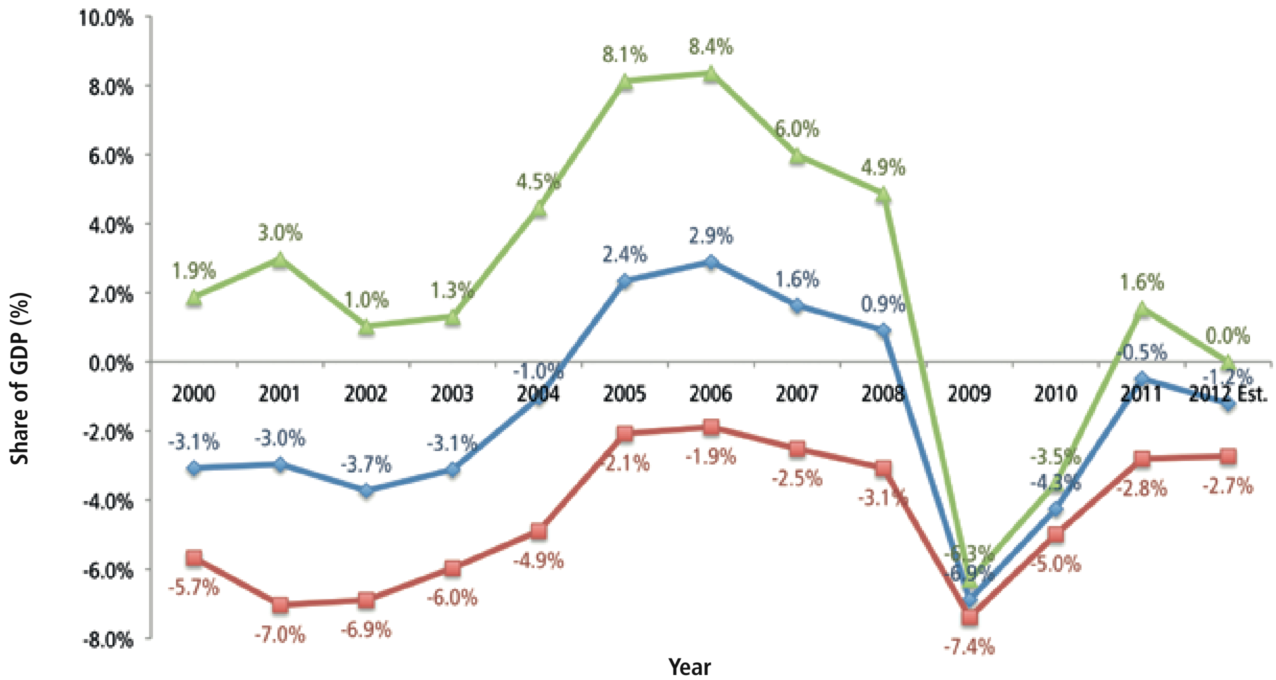
In contrast to previous years, external trade was an area of weakness, with exports growing a very modest 2.3%. This came after two years of robust export growth of nearly 26% in 2010 and 28% in 2011. While a portion of these figures represented recovery from the trade crash in 2009 (when exports contracted 32.7%), exports reached historical record levels in 2011 both in absolute terms and as a share of GDP. By way of contrast, even though in nominal terms exports reached a record USD 923 billion in 2012, as a share of GDP they declined from 25.9% in 2011 to 25.8% in 2012.

Encouragingly, other key indicators show stable and sustainable trends. Consumer price inflation declined in all countries, continuing a trend of declining price pressures over the years. For the first time, all Black Sea region countries posted single digit rates of inflation, and for nine countries the rate was below 5%. What makes this achievement all the more impressive is that it occurred during a poor year for agricultural production. In the past, food output had resulted in sharply higher food prices, and since food has a significant weighting in the consumer "basket" of goods surveyed for calculation of price indices, this usually fed through to higher inflation in the economy as a whole. That this did not occur in 2012 was largely due to the effective monetary policies carried out over the years throughout the region. These policies have been applied consistently and established the credibility of governments' "inflation fighting" credentials and thus led to lower expectations of price increases.

Fiscal adjustment was also sustained, as in most countries budget balances for 2012 improved relative to the balances achieved in 2011. This is a continuation of a process of fiscal consolidation that began in 2010 in an effort to offset the large deteriorations experienced in late 2008 and 2009 when the post-financial crisis economic recession resulted on the one hand in a decline in revenues, due to reduced economic activity, and on the other hand in increased spending due to systemic stabilizers such as increased unemployment and welfare benefits, support to the financial sector to avert disruptions, and in certain instances fiscal stimulus efforts to counteract sudden and substantial declines in private economic activity.

The rapid bounce back of economic growth in 2010 and 2011 facilitated the efforts of governments to restore greater fiscal balance, and the impressive results are evident in Figure 2, as an overall adjustment in excess of 6% of GDP was achieved in a mere two years. In addition to the weighted average of fiscal balances for the whole Black Sea region, Figure 2 also shows balances for region minus Russia and Russia individually. This is because Russia carries a very high weighting in the calculation of regional averages, and as a result it can skew the overall average. This is especially relevant for budget data, since Russia usually posts sizeable surpluses on the strength of energy related revenues, while most of the rest of the Black Sea region posts fiscal deficits. For 2012, the Black Sea region sans Russia reduced its overall budget deficit a bit further, with most of the reduction attributable to the aforementioned slower government spending. By way of contrast, Russian government expenditures grew at a higher rate, relative to revenue growth, and after achieving a surplus in 2011, it was roughly in balance for 2012.

Figure 2: Trends in Average Fiscal Deficit of BSEC Region as a Share of GDP



Source: National Statistical Agencies & IMF-IFS
Note: Black Sea Region Average- Blue, Russia Alone- Green, Black Sea Region Minus Russia- Red

While there were some marked changes in the current account balances of individual countries, on the whole the external balance picture was mixed. Countries posting significant improvements in the current account balance included: Greece, which experienced a large decrease in its trade deficit due to an increase in exports and a very large drop in imports; Turkey, facing the risk of overheating due to burgeoning domestic demand growth and large capital inflows, sought to contain erosion of its external competitive position via a weaker lira combined with a restrictive but innovative monetary policy and tighter fiscal policy; and Armenia, which enjoyed an increase in remittances as well as stronger exports of manufactured goods. On the flip side, Azerbaijan, which along with Russia posts high structural trade surpluses due to energy receipts, experienced a sizeable decline in its current account surplus due to a contraction of production in the energy sector in 2012, which accounts for over 90% of exports. Countries such as Serbia and Ukraine experienced rises in their current account deficits due to declines in agricultural exports and weak demand for their manufactured exports (which were further hurt by declining prices for commodities such as steel). Other countries experienced small movements and more or less continued with the trend from the previous year.

In most countries, public debt levels and trends were little changed relative to 2011. Levels remained stable and relatively low. Ten out of the twelve BSEC countries have public debt levels below 45% of GDP, and in three cases – Azerbaijan, Bulgaria, and Russia – public debt levels are below 20% of GDP. Where differences exist, it is in the composition of external versus domestic debt, as countries with less developed financial sectors and weaker domestic resource mobilization are generally more dependent upon external sources of financing. Lingering concerns exist about uninterrupted access to finance on global financial markets, an unfortunate legacy of the September 2008 global financial crisis. Nevertheless, even for countries with a large share of foreign owed public debt, risks are low since the absolute debt levels are relatively low, year-on-year trends are stable, and much of this debt is owed to official institutions such as the International Monetary Fund (IMF), with which a number of countries have lending arrangements, as well as bilateral lenders and other multilateral and bilateral development finance institutions.

Greece, and to a much smaller extent Albania, represent the two exceptions. In the case of the former, with the Eurozone crisis continuing, public debt levels remain high although they declined substantially during 2012. Moreover, after three years of austerity, Greece's "twin deficits" – fiscal and current account – have declined substantially, and a primary fiscal surplus is expected in 2013. Albania's public debt is significantly lower and more manageable. External debt levels appear sustainable, since it is mostly domestically owned, and while there are concerns about a rising trend in recent years and a heavy reliance on short term debt which increases rollover risks, achievement of larger primary fiscal surpluses would substantially facilitate domestic debt management.

External debt owed by the private sector also remained stable or declined for the most part, well below the levels reached in the lending boom prior to the 2008 global financial crisis. Since the crisis, this figure has emerged as a key indicator of potential vulnerability as a number of countries with low public debt levels nonetheless found themselves in dire predicaments when domestic banks and firms were unable to service or roll over large external debts which they had accumulated after international capital markets froze and access to financing was lost.

The crisis was thus imported through the private sector and brought about the economic contraction observed in 2009, and faced with imminent collapse of large numbers of banks and firms, governments were forced to provide official support to domestic financial systems, a necessary (and ultimately successful) but expensive and politically controversial undertaking. In the aftermath of the crisis, borrowing from abroad has been muted, and governments have carefully monitored trends, discouraging growth in external debt accumulation. The principal exception to this trend was Turkey, which experienced a small surge in privately owed external debt levels as a result of its popularity as an investment destination and the increasingly attractive financing terms available to its private sector. However, the increase was only from 27% of GDP to 33%, an amount that remains eminently manageable, especially in view of the depth and sophistication of the Turkish financial system and its regulatory bodies.

Table 2: Select Financial Indicators for 2012, by BSEC Member Country

	Credit / GDP	Credit Growth	Capital Adequacy	Non-Perf /g Loans
Albania	67.6%	0.6%	16.2%	21.1%
Armenia	40.0%	26.6%	16.8%	3.7%
Azerbaijan	23.6%	27.8%	15.2%	5.9%
Bulgaria	70.6%	3.0%	16.7%	16.6%
Georgia	32.5%	12.9%	17.0%	4.0%
Greece	135.5%	-17.8%	9.5%	18.7%
Moldova	42.4%	14.2%	24.4%	14.5%
Romania	47.3%	0.5%	14.6%	18.2%
Russia	42.6%	20.0%	13.7%	6.5%
Serbia	60.7%	13.0%	17.3%	20.4%
Turkey	58.7%	16.4%	17.9%	2.9%
Ukraine	73.5%	7.1%	18.1%	19.8%

Sources: National Statistical Agencies and Central Banks
Note: Credit columns are for the full year. Capital Adequacy and NPLs are at end 2012, or latest available.

Table 2 shows that domestic borrowing, as measured by growth in credit, was for the most part relatively restrained. Armenia, Azerbaijan, Georgia, Moldova, Russia, Serbia, and Turkey experienced double digit credit growth, with Azerbaijan leading the pace. By way of contrast, Greece experienced substantial deleveraging as domestic banks were unwilling or unable to lend to the "real" economy, faced with high degrees of uncertainty and the imposition of losses from debt restructuring and rising non-performing loans due to economic distress.

The slow credit growth is a natural consequence of the continuing post global financial crisis atmosphere of uncertainty, as banks have become more risk averse, regulators warier about trends and vulnerabilities, and consumers and firms more cautious about taking on debt. While this denotes a welcome departure from the free-wheeling credit binge prior to September 2008, the degree of this shift to greater prudence has resulted in substantial actual and opportunity costs for economic activity. Beyond Greece, which has a large and mature financial sector – albeit one which faces difficulties due to the Eurozone crisis and the country's severe economic contraction – the size of financial sectors relative to the overall economy of other Black Sea countries is either modest in size or very small. This applies even to the relatively sophisticated markets of Russia and Turkey, which offer an increasing variety of products and instruments, but whose overall size has yet to reach full potential. More specifically, in the modest category are countries such as Albania, Bulgaria, and Ukraine with domestic credit to GDP ratios in the neighborhood of 70–80%. Remaining countries have much smaller financial sectors, for the most part with a domestic credit to GDP ratio below 50%.

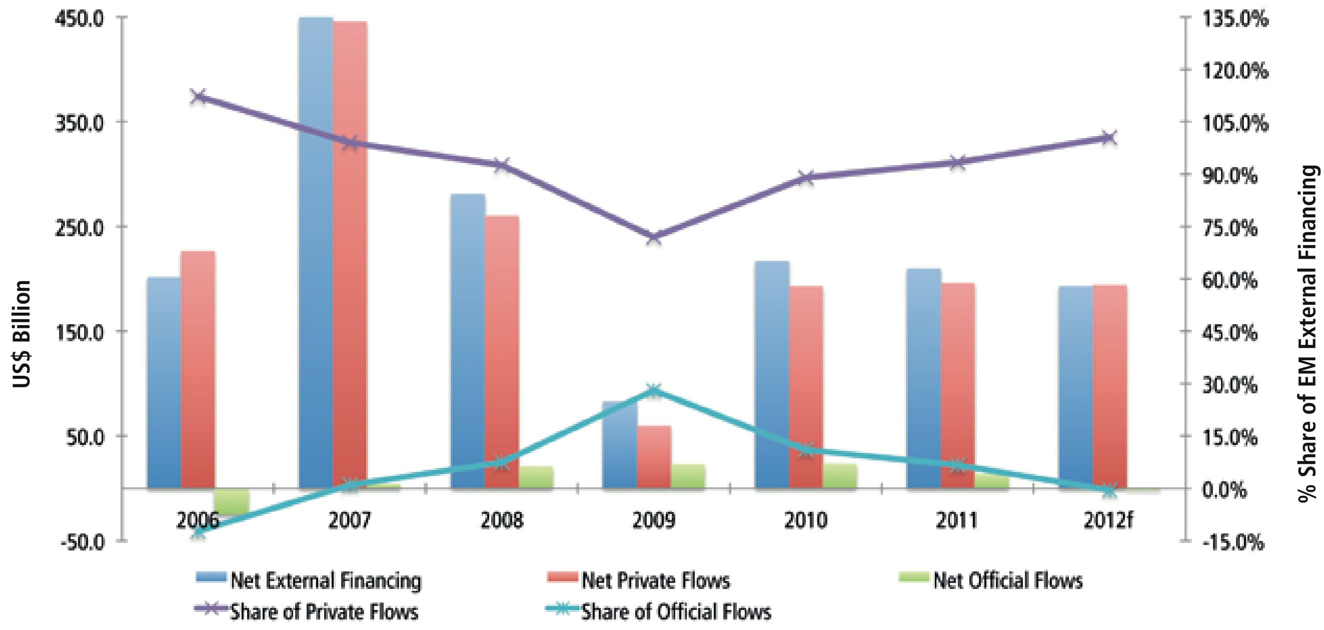
The implication of these ratios is that, on the whole, financial intermediation in the Black Sea region is weak, as banks and other financial institutions do not attract significant levels of savings which they could then intermediate and lend in order to generate new investment and additional economic activity. Less activity means smaller markets, less competition among financiers – especially in highly concentrated markets with a few dominant players – and higher costs for end-borrowers, be they businesses or consumers. Over the longer term, it also means foregone economic growth, as the failure to mobilize greater levels of resources efficiently reduces the availability of such financial resources to potential investors. Weak domestic financial mobilization was one of the reasons that regional firms had so actively sought external financing during the pre-crisis credit boom period, even though it left them vulnerable to sudden external changes in risk appetite. Domestic creditors tend to have a more compatible risk appetite and to be significantly less susceptible to sudden waves of risk aversion when difficulties arise or an economy experiences a shock.

It is a challenge recognized throughout the region, and one of the reasons that key authorities have sought to strengthen the role and independence of central banks and regulatory bodies in the execution of monetary policy and banking supervision, while also creating a competitive environment to attract investment. Domestic banks have been encouraged to increase their role throughout the region, but it is at best a slow and lengthy process and will represent a challenge for the foreseeable future.

Furthermore, the prevailing climate of high risk aversion up to mid 2012 has proven an impediment to these efforts, aggravated in particular by the crisis in the proximate Eurozone. Under regular circumstances, global conditions would be considered highly favorable for increased capital flows to emerging markets such as the Black Searegion since these economies enjoy solid macroeconomic fundamentals, better growth prospects, and expectations for much higher returns than the wealthy economies of Western Europe. For their part, wealthy economies are awash with cash, due to the exceptionally loose monetary policy being followed in Western Europe (as well as the United States and Japan), which combined with the prospect of poorer returns domestically would normally push capital towards other destinations. Normally, Eastern Europe would be the first and favorite destination as Eurozone based banks and investors have been key actors providing financing to the CEE & Baltics and the Black Sea regions.

Yet, as Figure 3 shows, financial flows into Eastern Europe – including the Black Sea region – declined for the second straight year in 2012 and were less than half of the (admittedly excessive) levels achieved in 2007, just prior to the crisis. These declines are far more precipitous than for other regions such as Asia or Latin America, flows to which over the last couple of years have exceeded their pre-global financial crisis peak achieved in 2007. That the levels achieved in those regions are not even high is because a number of countries considered attractive by markets (e.g. Brazil) resorted to capital control measures in order to limit inflows, for fear that the latter can reduce external competitiveness and have destabilizing effects upon the local economy when they are rapid and large. By way of contrast, Eastern Europe suffered disproportionately from the risk aversion created by the Eurozone crisis, something reinforced by a recovery of flows in the second half of 2012 after fears subsided and commercial bank financing in particular began to recover.

Figure 3: Capital Flows to Emerging Europe (BSEC Region and CEE & Baltics)

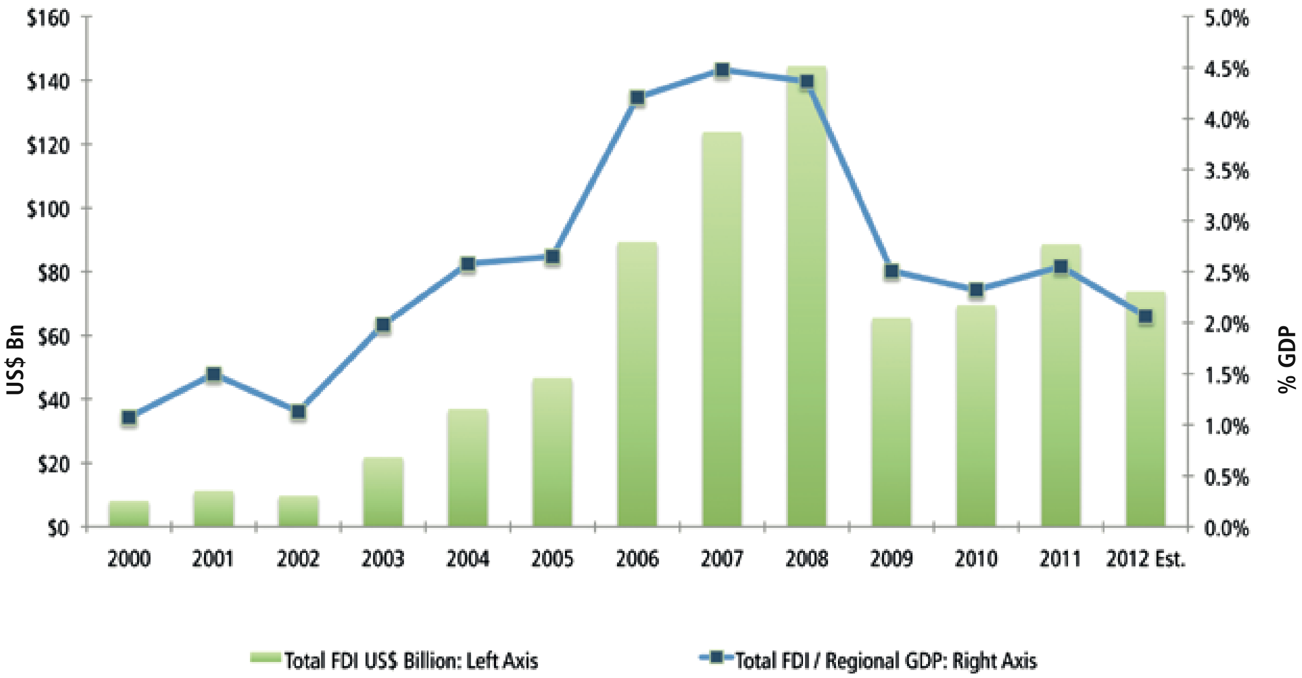


Sources: International Institute of Finance

A second, structural factor affecting financing flows and with implications for prospects in coming years is that western European banks have been forced into a process of deleveraging due to more stringent capital requirements and increased uncertainties about changes to the regulatory environment. They have been the primary sources of lending flows to Eastern Europe and have also been significant investors, especially in the CEE & Baltics and the western BSEC region where foreign ownership by Eurozone based banks dominates local banking sectors. Thus, pressure to deleverage will contain both the willingness and the ability to continue expansion into Eastern Europe. Worse, in cases of duress, there are risks that parent banks may resort to withdrawing funds from subsidiaries back to the "center" in order to meet the requirements at home, thus starving regionally based banks of available resources.

What is true for capital flows generally, applies to foreign direct investment (FDI) specifically. After two consecutive years of growth, FDI into the Black Sea region declined both in absolute and relative terms in 2012. As Figure 4 shows, relative to 2011, FDI declined by nearly 17% from USD 89 billion to USD 74 billion. As a share of GDP, the drop was from 2.5% in 2011 to 2.1% in 2012 and is the lowest level achieved since 2003, when the investment boom was still at an early stage. FDI in 2012 was nearly half the level of the peak year of 2008, with activity particularly slow in the first part of the year and somewhat brisker in the second half after the Eurozone crisis subsided. Attributing this uptick so quickly to remission of the Eurozone crisis is tricky, since FDI takes longer to plan and implement, particularly in an upward direction, relative to portfolio investment or lending activity. However, it portends favorably for 2013. For purposes of comparison, the FDI results are very similar to those observed in the CEE & Baltics, where FDI declined by 16% in 2012 relative to 2011, and as a share of GDP the drop was from 2.7% to 2.4%.

Figure 4: Foreign Direct Investment in the Black Sea Region 2000–2012



Source: National Statistical Agencies & IMF-IFS

Among individual countries, Armenia represented the only case where FDI levels increased. Armenia, alongside Albania and Georgia, were the only three regional countries to attract FDI in excess of 5% of GDP. This is in sharp distinction to 2008, when nine out of twelve countries attracted FDI in excess of 5% of GDP.

Normally, FDI is a useful indicator for assessment of how the business environment in a particular country or region is perceived by principals, namely the investors who are putting their money at risk. There is an obvious connection between the ease of doing business in a particular location and the attractiveness of that location for external investors and financiers. In this respect, the Black Sea region suffered from the broader risk aversion that was particularly pervasive in the Eurozone in the first half of 2012. Fears of contagion and a general reluctance to invest or provide financing took their toll, even though the region continued to fare well by other measures of the quality of the business environment.

In the 2012–13 edition of the World Economic Forum's *Global Competitiveness Report*, seven Black Sea countries improved their ranking relative to 2011–2012, out of which six achieved a substantial improvement of nine or more places. Turkey rose 16 places to 43rd overall, Bulgaria 12 to 62nd, Georgia 11 to 77th, Armenia 10 to 82nd, Azerbaijan nine to 46th, and Ukraine also nine to 73rd.

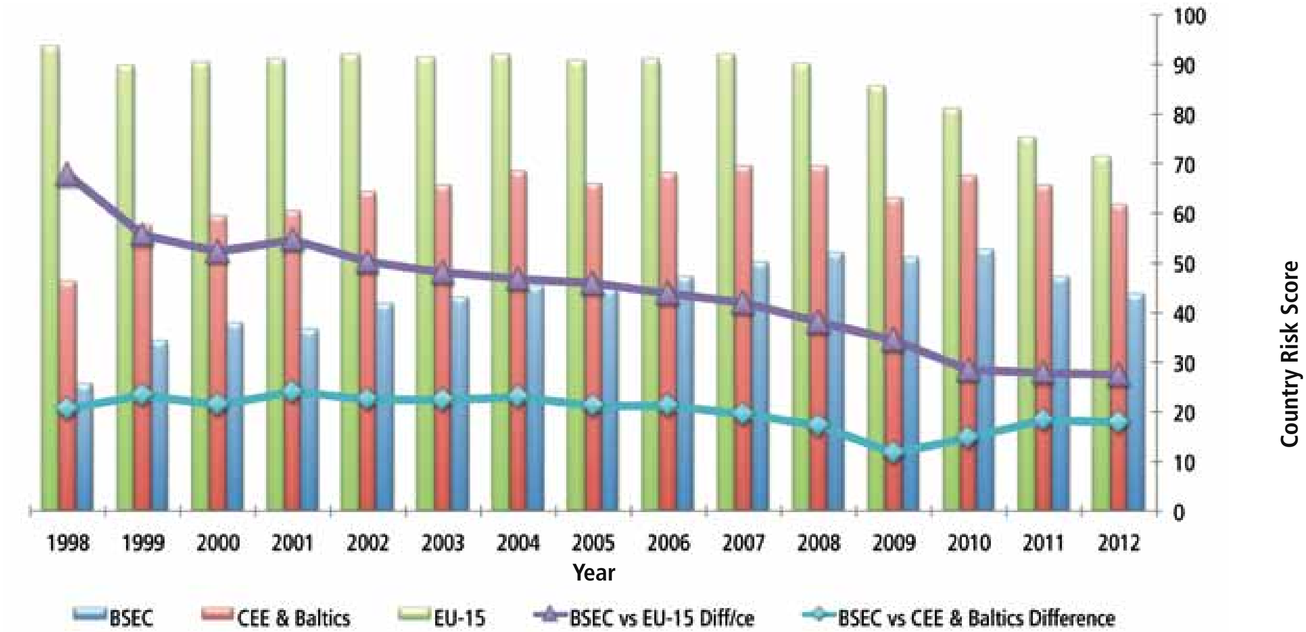
Progress achieved is further corroborated in the World Bank's 2013 *Doing Business Report* (which covers reforms in business environment during 2011–12), the most systematic and analytical review of the absolute and relative business environments of 185 countries, including all BSEC members. Black Sea countries have been among the star reformers acknowledged in the *Doing Business Report* over the years, and 2011–12 was no exception. Three countries are ranked in the top ten economies improving the most across three or more areas measured by the report: Ukraine, tied for second, Greece which was eighth, and Serbia which was ninth. All Black Sea economies have enacted measures and reforms that have led to improvements in their overall business environment score, and five are acknowledged as ranking among the top 50 reformers since 2005: Georgia in first place, Azerbaijan in 13th, Armenia in 19th, Ukraine in 20th, and Albania in 50th.

The improving trend over time can be viewed in the evolution of country risk in the Black Sea region, another broad measure of the quality of the business environment. Country risk assesses the likelihood of a non-business event occurring or a non-business related situation transpiring, which would threaten (i) normal operation of a company, (ii) the value of assets, and/or (iii) the profitability of loans and investments. The better (e.g. lower) that the level of country risk is in a country, the better the business environment tends to be. Figure 5 shows collective country risk developments for the Black Sea region ("BSEC") as well as how it fares relative to: (i) the fifteen countries that comprised the European Union prior to its 2004 expansion (the "EU-15"), and (ii) the eight CEE & Baltic states. The figure collates country risk scores as measured by Euromoney Magazine in its periodic *Country Risk surveys*[4].

The chart shows that from 1998–2008, the Black Sea region steadily improved its measures of country risk. In 2009, in the aftermath of the crisis, it suffered a decline in its score – that is an increase in country risk. It resumed its pattern of improvement in 2010 but experienced setbacks in 2011 and 2012 in absolute terms. The 2009 decline is the result of the global financial crisis of 2008 and its subsequent economic downturn, which afflicted the entire region. The 2010 improvement coincides with the resumption of growth, while the declines in 2011 and 2012 are linked to the Eurozone crisis, and the fears of contagion which affected economic growth and investment flows.

4 Euromoney's *Country Risk survey* is a comprehensive index, covering nine categories. Figure 5 provides summary regional representations based on arithmetic averages. They are not weighted to account for the relative size of economies' other factors. The figure was prepared for illustrative purposes and shows the evolution of country risk scores over time. For the bars, an increase in score means an improvement (e.g. lowering) of country risk, with 100 representing the maximum (e.g. lowest risk) score. For the lines, a declining trend indicates decreasing differences in country risk scores between the regions being compared (e.g. convergence of scores and country risk levels).

Figure 5: Regional *Euromoney* Country Risk Scores & Relative Differences



Source: Euromoney Magazine

Relative to the two key comparison groups (a) the EU-15, and (b) the CEE & Baltic states, the Black Sea region continues to show improvement, especially relative to the former. Despite slipping in 2011 and 2012, Black Sea countries have continued to narrow the difference in country risk vis-a-vis the EU-15, as shown by the decline in the line which measures differences between the two. Risk perceptions relative to the CEE & Baltic states also show a narrowing of risk perceptions, although the difference has been smaller, and the trend has proven more gradual and stable over time.

Positive trends in the business environment extend to sovereign credit ratings of Black Sea countries, although the global financial crisis and its aftermath have undone some of the progress that had been achieved (See Table 3)[5]. Every Black Sea country receives at least one sovereign rating from one of the three largest and most established credit rating agencies which dominate the market. This signifies growing maturity and sophistication of regional economies, as well as progress since these ratings are in many cases essential for accessing international capital markets. Domestically, they also help to set key benchmarks, which in turn facilitate the development and deepening of local financial markets.

Many regional economies were downgraded during 2008–2009 as they experienced the impact of the global crisis, and while aggregate ratings are still below the levels attained prior to the crisis in 2007, a number of countries have subsequently achieved upgrades. Significantly, whereas in 1999 the Black Sea region had only one country rated with an investment grade, by end 2012 it had five with at least one investment grade rated by one of the principal rating agencies.

5 Long term sovereign credit ratings have flaws and limitations as indicators of the business environment, since they supposedly measure creditworthiness first and foremost. But they can be useful proxies, and they enjoy the virtues of recognition and easy comparability, as they analyze elements relating to country risk which correlate to the quality of the business environment. Investment grade refers to a sovereign credit rating of Baa3 or better according to Moody's, and BBB- or better according to Standard & Poor's and Fitch.

Table 3: BSTDB Sovereign Credit Ratings Comparison end 1999 vs. end 2012

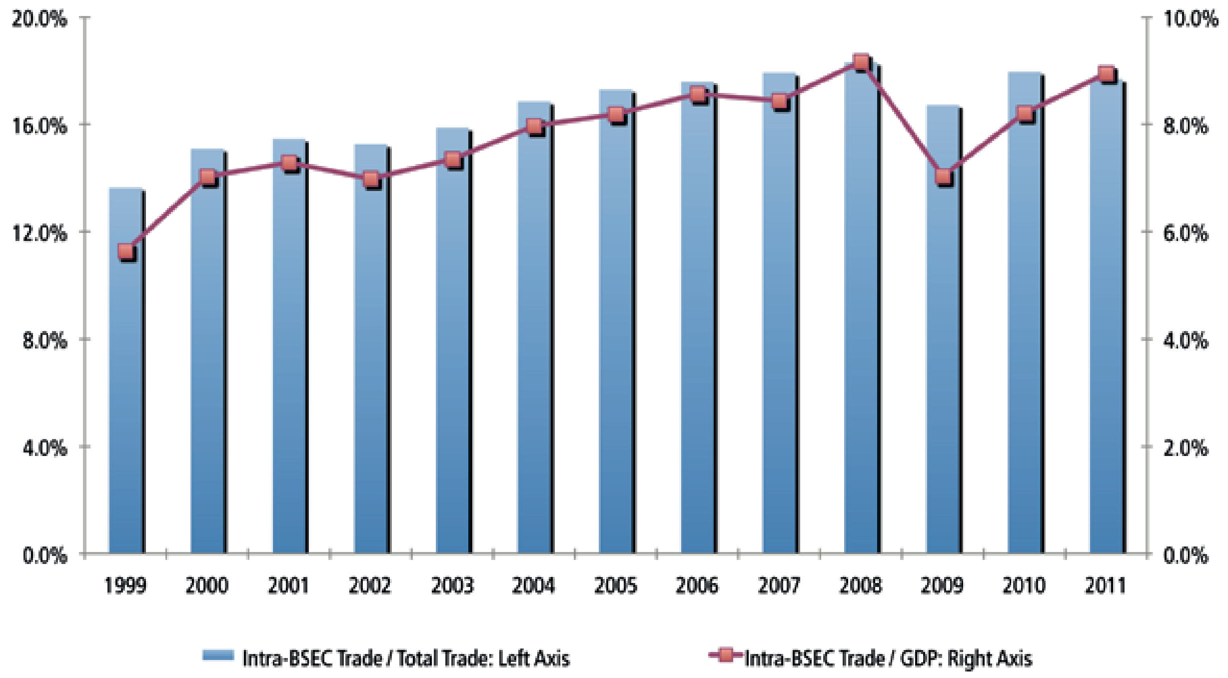
	December 1999			December 2012		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Albania	–	–	–	B1	B+	–
Armenia	–	–	–	Ba2	–	BB-
Azerbaijan	–	–	–	Baa3	BBB-	BBB-
Bulgaria	B2	B	B+	Baa2	BBB	BBB-
Georgia	–	–	–	Ba3	BB-	BB-
Greece	A2	A-	BBB+	C	B-	CCC
Moldova	B2	–	B-	B3	–	–
Romania	B3	B-	B-	Baa3	BB+	BBB-
Russia	Ca	SD	CCC	Baa1	BBB	BBB
Turkey	B1	B	B+	Ba1	BB	BBB-
Ukraine	B3	–	–	B3	B	B

Source: Credit Rating Agencies

As a whole, the region recorded a very slight current account surplus equivalent to 0.1% of GDP in 2012, although Table 1 shows that there was considerable variation from country to country. In contrast to 2011 and 2012, growth in trade was low and its contribution to GDP growth much more limited. In absolute terms, aggregate regional exports in 2012 grew 2.3% to USD 923 billion, and regional imports in 2012 fell slightly by 0.1% to USD 856 billion. While the combined absolute numbers are record figures, the growth rates are well off the 28.4% for exports and 28.5% for imports recorded in 2011. Although the overall picture appears sluggish, it was linked to the difficulties and slowdown experienced in the Eurozone, the principal trading partner for the countries of the Black Sea region. Thus, as the Eurozone crisis subsided in mid-2012 and activity picked up in the latter part of the year, trade patterns followed suit.

Figure 6 shows trends in intra-regional trade within the Black Sea region. In previous years, the trend for Black Sea trade figures was that they moved in the same direction as overall external trade flows, but the rates of change were more amplified. That is, intra-regional trade grew (or declined) as did overall external trade, but it did so at a faster pace. Thus, in the years of growth, from 2000–2008 and the recovery year of 2010, intra-regional trade expanded more quickly than overall external trade and showed an increasing share relative to the size of the economy, and as a proportion of total trade. Likewise, in 2009, the decline in intra-regional trade was bigger than the decline in overall trade, as is evident from the figure.

Figure 6: Intra-Regional Trade Flows in the Black Sea Region 1999–2011[6]



Source: National Statistical Agencies & IMF-IFS

Irrespective of the trends, intra-regional trade flows around the Black Sea remain low, especially when compared to other maritime regional blocs such as those around the Baltic Sea, the North Sea, or even Mediterranean Europe which stretches across the entire southern length of the continent. These regions are more highly integrated economically, and flows of trade and investment among them are notably higher. Significantly, they are also integrated politically and share a number of common institutions since they are either EU members or tightly linked to the EU[7].

By way of contrast, the Black Sea region contains countries within the EU, or with EU membership prospects (as candidates or potential candidates) as well as countries without any EU membership prospects and consequently, no institutional links with the EU. As a result, intra-regional trade flows are less developed, with the EU in some instances helping to foster closer trade links (as is the case in the western BSEC region in which EU members, candidates, and potential candidates are located), and in other instances hurting closer trade links. EU linked states have relinquished control of their trade policy centrally to Brussels, and therefore they are restricted from pursuing bilateral or sub-regional trade arrangements with the non-EU linked states; the non-EU linked states must negotiate on their own with the EU as a whole, a much slower process since the 27-member-EU has highly diversified interests and prospects among its members, and countries in other parts of Europe are virtually unaffected by the lack of close trade ties. However, such underdeveloped commercial ties among neighboring states of a sub-region represent significant real and opportunity cost for Black Sea countries, in the way of foregone economic growth, competitiveness gains, and increased effective market available to regional firms.

An additional consideration (linked to market size) is the extent to which a "safe haven" exist for firms and banks to fall back upon in times of turmoil when external trade prospects diminish. Tightly linked regional markets tend to operate as a domestic market, with locally based financiers and firms less likely to be scared away by downturns or shocks for

6 Overall export and import estimates for 2012 were available at the time of publication for BSEC countries, but full bilateral figures country by country were not. Due to this measurement lag, only figures up to 2011 are discussed and shown in the figure.

7 For example, Norway is closely associated, while Croatia is due to join in 2013.

reasons which may include (i) greater knowledge of and comfort operating in neighboring markets which share many of the characteristics and culture of a firm's home market, and (ii) inability to flee, since a neighbor will remain a neighbor, and regional problems may spill over, or problems need to be dealt with since abandonment is not possible (not to mention that a bit of foresight, commitment, and even magnanimity may reap future goodwill and rewards).

As a region, the Black Sea in 2012 had an estimated (i) GDP of around USD 3.6 trillion, (ii) population of 327 million, and (iii) an average per capita income of nearly USD 11,000. While these figures hide considerable differences in wealth, size, economic structure, and growth trends, they highlight the tremendous possibilities that exists for broader and deeper economic cooperation among the countries of the Black Sea. To do this would require political will and effort to open "pathways" for discussion of issues of common interest, some policy harmonization, and consideration of expanded physical infrastructure links (especially in transport, energy, and communications). The private sector has historically responded dynamically to such "positive signals", with financing, investment links, and trade ties sharply increasing in the aftermath of the trailblazing political initiatives.

In Focus: Sources of Economic Growth in the Black Sea Region 2013 and beyond

The Economic Cycle and the BSEC Region

Economic growth tends to occur in a cyclical pattern, with the major shareholding countries of BSTDB in various stages of the economic cycle. As it appears now:

- Romania and Turkey are in Mid-cycle growth phase;
- Bulgaria and Russia are in Late-cycle growth phase;
- Greece and Ukraine are in the "winter" phase of the cycle.

Currently, the Eurozone is in recession, which is expected to continue in 2013 and thus to affect BSTDB Member Countries through lower capital inflows, lower value of remittances, and lower demand for regional exports.

The global economy is projected to just inch up timidly in 2013. Financial markets will remain volatile and uncertain, and the volume of global trade is not expected to grow significantly.

This uneven distribution of Member States over the economic cycle and the various degrees of exposure to external factors require a differentiated approach to policy in order to either take advantage of the opportunities or to mitigate the challenges the Member Countries of BSTDB face. Notwithstanding the above, there are a number of commonalities, which underpin economic growth and development.

The Need for Economic Growth

From 2000 to 2008, growth in the region was based on FDI inflows, credit growth, increases in domestic demand, investment, but in particular export growth to Western European markets. This traditional growth model appears now to have been transitional. It came into question during the recent global financial crisis, and it has de facto come to an end with the economic setback of 2012, and the entry into recession of the Eurozone in 2013. The large inflows of private foreign capital are no longer granted, financial sector deleveraging in the countries of parent banks has put its mark on credit availability, and fiscal contraction, has resulted in negative shocks for the domestic private sector.

Economic growth is intrinsically linked to development. In order to secure sustainable economic growth, Member States would need to take into consideration the following constraints imposed by recent developments in the global economy:

- First, export growth has in broad terms reached its limits, as in an age of austerity and stagnation demand from developed economies in general, and EU partners in particular, has weakened. One just cannot expect that all countries simultaneously, while reducing domestic demand, can increase output for selling in foreign markets.
- Second, firms now organize production through regional and global value chains, distributing the production process across the world. Intermediate inputs make up the majority of global trade. In essence, about two thirds of global trade is intra-company trade.
- Third, access to foreign financing is scarce and uneven, with higher levels of risk aversion among the investor community than in the recent past.
- Fourth, and not lastly, it appears that the crisis has induced a significant permanent decline in the rate of potential GDP growth.

The economic growth model has to be reconsidered in light of the complex interdependencies that govern the international trade and monetary system. Growth potential is strongly influenced not only by the BSTDB Member States domestic production structure but also by their external linkages.

This redirects the focus of attention toward domestic growth drivers and the role of technological change for the region's growth potential, and in particular, to total factor productivity (TFP) as the part of economic growth which cannot be attributed to the accumulation and varying utilization of production factors.

In the context of transition and emerging economies with a short history of rapid growth and convergence toward more advanced economies,

- first, it is necessary to take into account linkages between sectors as well as changes in the economic structure over time;
- second, this development makes it even more urgent for BSTDB Member States to induce growth of manufacturing industries; and
- third, it is desirable to take advantage of the yet unused potential for regional cooperation and take advantage to a larger degree of existing complementarities.

In this context, it may be argued that growth potential in the Black Sea region is conditional upon:

- Initial conditions at the outset of the transition period that have shaped the long-run growth path.
- Structural reforms, which have played an important role in the transition process, but are still incomplete and need to be accelerated.
- The BSTDB Member Countries have yet to go through various phases of structural adjustment in order to reach their true long-run economic equilibrium.

The Quest for Sustainable Growth

Economic growth is an essential requirement for development, and the major contributing factor to poverty reduction. Furthermore, lower poverty and income inequality are in turn conducive to economic growth. Unfortunately, income inequality is high and also rising. The average share of income captured by the richest 10% is now about ten times that of the poorest 10% – a ratio of 10 to 1. For example, we see this trend in OECD countries, with the average ratio at 9 to 1, up from 1985 when it was 7 to 1.

Table: Inequality, Income distribution, and Savings

Country	Inequality Gini Coefficient*	Share of income top 10%	Share of income lower 10%	National Savings Rates** (%)
Albania	34.5	28.9	3.5	15.1
Armenia	30.9	25.4	3.7	19.6
Azerbaijan	33.7	27.4	3.4	46.2
Bulgaria	28.2	22.8	3.3	21.4
Georgia	41.3	31.3	2.0	5.2
Greece	34.3	25.3	2.5	4.1
Moldova	33.0	25.9	3.0	12.8
Romania	30.1	25.0	3.3	22.2
Russia	40.1	31.7	2.6	24.7
Turkey	39.0	29.4	2.1	13.3
Ukraine	26.4	23.2	4.1	17.7

**) Source: World Bank, UNDP 2008 Gini of 0 reflects perfect equality*
***) IMF 2010 (EU=18.5%)*

There are finite limits to growth based only on foreign relocation of production facilities in search of "pro-business" environments, such as low cost moderate skills labor, low taxes, low levels of social protection and health and safety standards, and a disproportionate share of disposable income that goes to remuneration of capital vis-a-vis the share that goes to remuneration of labor.

Social Inclusion

For growth to be rapid and sustained, it should be broad-based across sectors and inclusive of the large part of the work force. In order to maintain high rates of economic growth and continue the catching-up process, labor and capital will have to become increasingly important as determinants of economic growth. Higher rates of labor participation, more efficient use of available resources in general could become cycle neutral if coupled with a more equitable distribution of income between labor and capital. High employment and participation rates, a skilled workforce, and the efficient allocation of labor are crucial for real convergence of the countries in the region with the EU15.

Renewable Energy and New Technology

All countries are now looking for forms of growth that use resources more efficiently. Energy generation and transportation may be among the earliest drivers of greener growth, and this means changes that will affect everything, such as land values, urban planning, and farming. In agriculture, where there is a huge untapped potential, new technologies may play a role in helping the region becoming a major food producer and exporter.

Manufacturing remains central to Black Sea region economies, in terms of productivity and income growth, and for innovation. But while there may not be many new jobs in existing manufacturing capacity, successful new investments will stimulate job creation in upstream and downstream sectors, not to mention in related services.

None of this would be possible without knowledge. The knowledge based industries – IT, biotechnology, renewable energy, technical support services, new organizational structures, marketing and advertising skills – are potential new sources of economic growth.

Continuous Education

Given the state of technology, non-inflationary, sustainable growth depends crucially on the long-term trend of productivity growth. But most of all, countries have to invest in innovation and skills, set out innovation and green growth strategies, and review regulatory incentives.

The shift to the production of high value added goods and services is facilitated by increased efficiency of production through adoption of technological change, increased utilization of capital, and higher work intensity.

Higher wage rates for extra effort of workers deriving from higher degree of utilization of labor, the more rapid depreciation due to higher capital utilization, lower total average cost of production, higher total revenues all contribute to increasing domestic demand for goods and services and thus, through spillover effects, trigger further increases in productivity.

Determinants of Economic Growth

Natural Resources – the potential for growth of an economy depends to a significant extent on the resources it has. Endowment of natural resources may help the economy to expand if there are the skills and technology to exploit the opportunities.

Savings Rate – to provide funds for investment, there needs to be a high level of savings. Higher savings mean higher investment and thus in turn mean more growth in the future. The level of investment in any economy depends to a large extent on the availability of domestic savings, and the ability to mobilize and intermediate these savings effectively. High-growth economies typically set aside a large share of their income, typically 20 to 25%. However, savings rates in Eastern and South Eastern Europe in general have been fairly low. In these countries, between 50 and 70% of investment is financed with companies' own resources. The difference is made by bank credit and FDI. An important additional source of investment may be represented by targeting productive use of remittances.

Many countries adopt newly recommended regulatory changes to make financial markets more stable and competitive, and implement measures aimed at protecting citizens from the volatility of markets. These combined efforts will create in the medium–to long-term a banking environment that is more transparent and stable. Measures to increase confidence in the financial sector and promote competition will better serve customers, and are likely to also induce higher levels of savings.

Physical Capital / Infrastructure – the existing stock of capital and physical infrastructure is still insufficient and not in a very good state. It is difficult to sustain rapid growth without high rates of public investment. Investment in infrastructure, but also in education and health, crowds in private investment by increasing the efficiency of private capital. Infrastructure works are boosting private economic activity and generate positive externalities. Public investment is key in the short run, and further private participation in such projects is a guarantee for long-term sustainability. Therefore, given the scarcity of public resources, it is essential to prioritize those public sector investments which have a high catalytic role and present the highest potential for positive externalities.

Human Capital – key to growth is the interaction between human and physical capital. Member States benefit from existing good stock of human capital, but in order to preserve such achievements and make further progress they need significant further investment in health, education, R&D. Higher quality of education and a high ratio of spending for research to GDP translate into a high rate of technological change. They also need to adopt policies conducive to the reversal of demographic trends – natural population growth, migration.

Institutions – for increases in public investments to lead to increases in private investments, the right economic, political, and legal framework should be in place. If the business climate is poor, public investment could have a "crowding-out" effect. Member States are in need of deep and rapid institutional reform, public sector reform in particular, improved governance, and reduced bureaucracy and corruption, in order to increase investor confidence and improve the ease of doing business and economic freedom indicators. These are all determinant factors for a stable economic environment and positive business sentiment. Building solid institutions, adopting and implementing good policies, and developing administrative capacity are preconditions for sustainable growth.

Public policy – policies need to remove the obstacles to the growth process by increasing investment in basic social services, social protection and infrastructure, and promoting environmental sustainability. Policies such as those aiming at macroeconomic stability, institutional quality, effective governance, and favorable investment climate should promote economic growth by increasing incentives, opportunities, and capabilities for employment and entrepreneurship.

Main Societal and Political Factors Affecting Economic Growth

There are two main internal factors that may influence economic growth:

- **Policy-induced** – these are policies aimed at boosting the economic activity, which are compensated by corrective deflation once growth objectives are achieved; and
- **Expectations** – these can have a powerful effect on growth through their impact on aggregate demand.

In addition to domestic factors, there are also two mainly external factors that may influence economic growth:

- **Random shocks** – events that are relatively unpredictable but have a significant effect on the economy; and
- **Imported cycles** – if the rest of the world is at turning points in the economic cycle, and the domestic economy has a high degree of integration in the global economy, then it is likely that the domestic economic activity will be affected through channels of foreign investment and foreign trade.

Sources of Growth and Economic Development

Identifying and developing new sources of growth depends on the capacity and ability to develop the intellectual assets needed to create, promote, diffuse, and adopt the innovations underpinning such growth.

Policymakers have to take a lead by permitting the emergence of new sources of growth and setting the regulatory ground to break down inertias, whether institutional or economic, that prevent breakthroughs to happen.

Capital accumulation – is a key factor underlying economic growth, particularly at earlier stages of development. Higher levels of investment depend on higher savings rates and on the ability of the financial sector to efficiently play its intermediary function. Investment is not only a direct contributor to higher output, it also brings more productive technologies and stimulates total factor productivity. Therefore, achieving higher investment rates should be a major objective for future growth in the Black Sea region.

A higher degree of financial intermediation is also positively correlated to total factor productivity growth. Financial intermediary sector alters the path of economic progress by affecting the allocation of savings; it is a policy which alters the savings rate. Therefore, securing a stable, solid, financial sector of a reasonable size relative to GDP should be a key concern of policy makers.

The region may present increased attractivity for investment in low-cost, skill-intensive, high-value added jobs. The key lesson for policy is to encourage the accumulation of knowledge-based capital, and to be able to capture as much value from the investment as possible. The environment for investment in knowledge-based capital is likely to determine which countries retain or move into the highly value-adding segments of different industries.

Ensuring good business frameworks, governments can help encourage firms to invest in certain high value functions, and while some low-skilled jobs will need to stay, or even increase, most growth should take place in higher value added sectors of economic activity.

Redirection of trade – the OECD markets face saturation for many products and services, but higher availability of such goods in other markets would meet an unsatisfied demand. By 2015 about 90% of global economic trade will take place outside of the EU. Economic recovery will therefore need to be consolidated by stronger links with the new global growth centers. Redirection of trade may take place in two dimensions:

- Exporting outside of the Black Sea region, to the rapid growing countries and regions of South-East Asia and Africa; and
- Taking advantage of the high potential for intra-regional trade and investment.

Reduction of poverty and income inequality – higher incomes and lower inequality impact on growth because this would mean higher demand for the domestic markets of BSTDB member states. High and rising levels of income inequality lower the poverty reduction impact of a given rate of growth and can reduce the political stability and social cohesion needed for sustainable growth. Limited social protection reduces the pace of growth. Inequality of wealth and opportunity hinders the ability of the poor and disadvantaged to participate in and contribute to growth. The IMF has found that growth is faster and over longer periods of time when inequality is lower, irrespective of the actual level of income. There is therefore a need for a mix of policies that addresses both growth and distributional objectives.

Structural Reforms Key to a Future of Hope

In all member countries there are outstanding issues related to the pension system, health care system, the tax system, labor and product markets. There is an increasing risk of poverty and social exclusion for a growing share of the population.

Structural reforms are needed to address rising inequality and the social costs of the crisis, particularly in countries with high structural and youth unemployment. Adopting and implementing, mutually supportive and effect enhancing employment and education policies would reinforce overall development objectives, including economic growth and social equity. Well-targeted and properly designed structural reforms can deliver results fast and efficiently, by exploiting synergies among complementary policies.

The cost of doing business affects location/relocation/investment decision of firms and thus job creation in manufacturing industries. Member States need to devise and implement reforms aiming to ensure predictable and stable legislation, and in particular to implement a stable, simple to understand, easy to administer fiscal code, with a limited number of taxes. Trade and investment liberalization is a major structural reform, creating new opportunities for innovation and stronger productivity growth. Eliminating barriers to establishing new businesses, liberalizing closed professions, reducing bureaucracy, and providing a level playing field for all domestic and foreign, including regional, entrepreneurs and businesses would provide an impetus to economic activity.

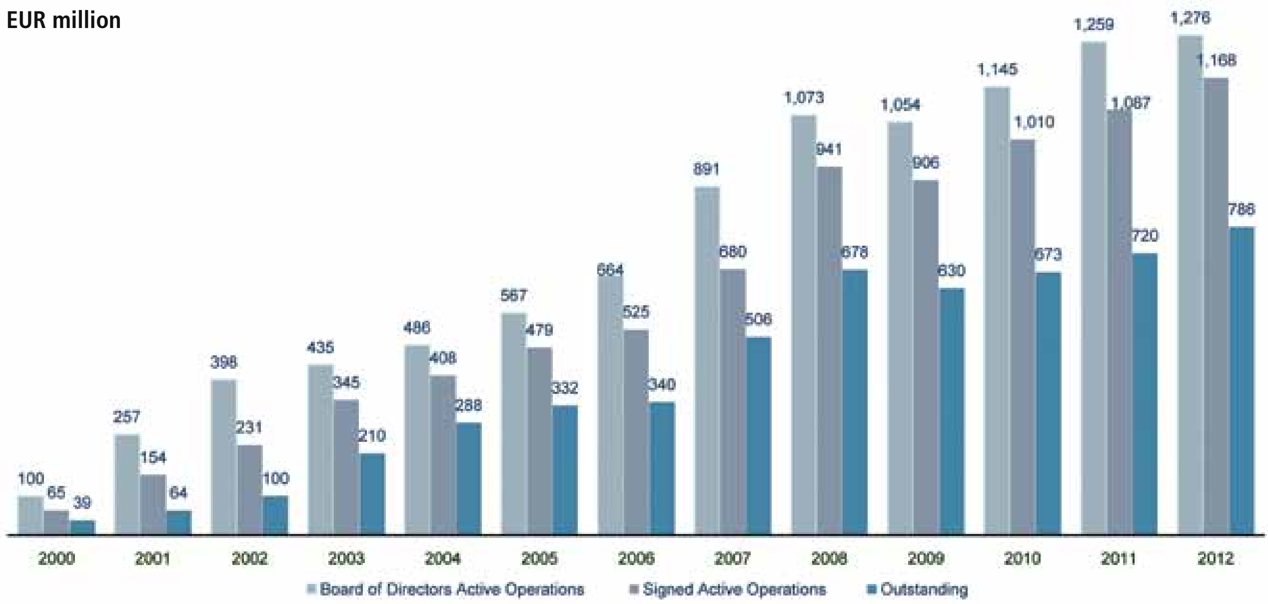
Addressing this issue not only improves well-being, it can also restore competitiveness and increase productivity. Some countries are already reaping the benefits of structural reforms implemented either prior to, or in the early stages of, the crisis.

BSTDB in the Black Sea Region

PORTFOLIO DESCRIPTION

Since the beginning of operations in June 1999, the Bank has approved 257 operations amounting to about EUR 2.74 billion. Throughout this period, there were 220 signed operations for a total signing amount of EUR 2.22 billion. A total of 173 operations for about EUR 1.67 billion were repaid. At end-2012, there were 100 operations in the active outstanding portfolio for EUR 785.9 million, a 9.1% increase from the end of 2011. At end-2012, there were 4 problem loans, duly provisioned, representing 7.99% of the value of the outstanding total portfolio.

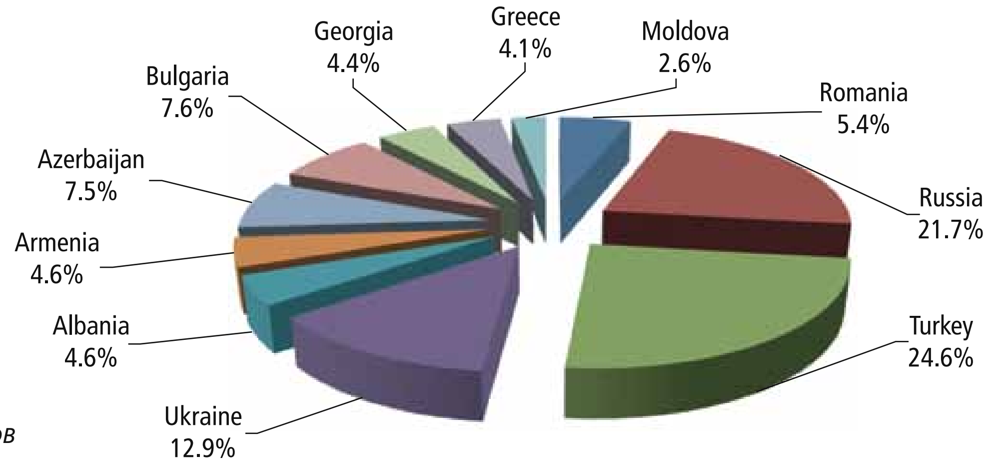
Evolution of Portfolio of Operations 1999–2012



Source: BSTDB

The structure of the Bank's active[8] portfolio of signed and outstanding operations by country and by sector is as follows:

Signed Active Operations by Country



Source: BSTDB

Selected BSTDB Financings in 2012

TAV EGE Airport Financing (Turkey)

The Bank was one of the leading arrangers mandated by TAV Airports Holding to provide a project finance facility to TAV Ege for the construction of the domestic terminal and the renovation and modernization of the international terminal of Izmir Airport in Turkey. The EUR 40 million loan with a maturity of 16 years is part of a EUR 250 million long-term debt facility put together by the BSTDB, the European Bank for Reconstruction and Development (EBRD), and commercial banks: Denizbank, Unicredit, and Siemens Bank.

The project involves demolishing the existing domestic terminal, designing and building a new domestic terminal, renovation of the international terminal, and operation and maintenance of Izmir airport in accordance with international standards, under a lease contract until 2032.

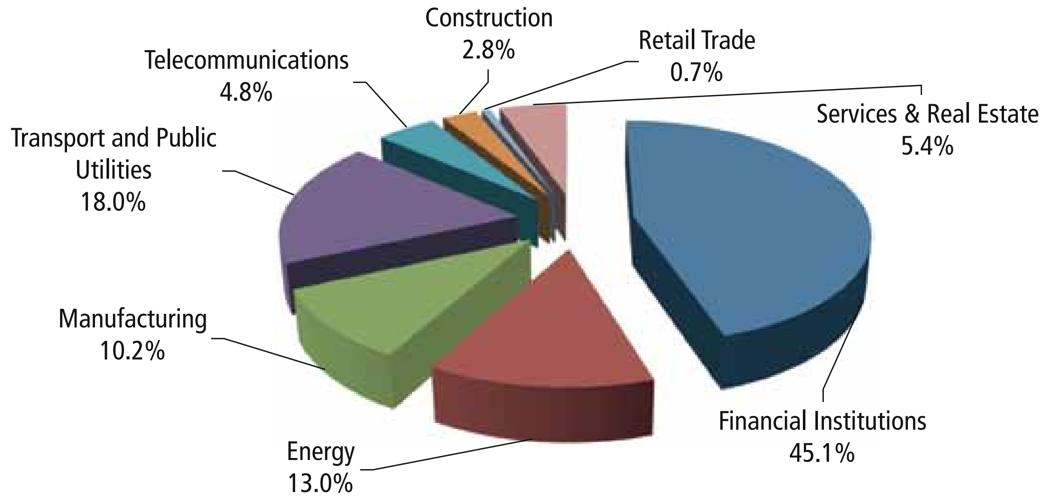
There are direct benefits expected from the investment of EUR 444.5 million to construct the new terminal and afterwards from the airport operation by TAV over the leasing period. An improved airport infrastructure is expected to have also indirect positive effects via the broader economic growth it facilitates in the region where it is located. Given the importance of tourism in Izmir region, these benefits are due to be even higher, since quality airport infrastructure is critical to fostering tourism growth over the long term.

TAV Airports, the owner of the special-purpose company TAV Ege, is one of the world's largest airport concession companies with operations at twelve airports in six countries. The company, together with its subsidiaries, provided services to about 575 thousand flights and 72 million passengers in 2012.

BSTDB Amount	**EUR 40 million**
Total operation cost	**EUR 444.5 million**
Type of financing	**Project finance**
Maturity	**16 years**

8 The active operations in the Bank's portfolio are those currently in any of the phases, from Board approval to full repayment (approved, signed, disbursed, and in repayment).

Signed Active Operations by Sector



Source: BSTDB

Selected BSTDB Financings in 2012

Olympus S.A. Corporate Loan (Romania)

A EUR 30 million corporate loan was provided in 2012 by the Bank to Olympus Romania, part of TYRAS Group (Greece). The seven-year loan financed company's investment program in the new dairy plant in Braşov. The plant construction is part of Olympus Romania overall investment plan of EUR 55 million including an initial self-funded investment.

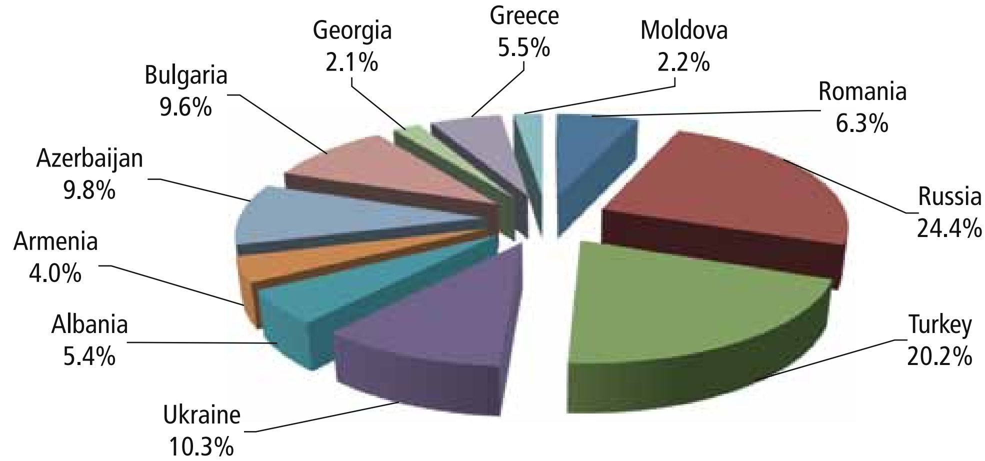
The BSTDB loan aims to support company's ambitious investment program, enabling Olympus Romania to substantially increase its efficiency and competitiveness and helping it comply with high environmental and quality standards for its milk, yogurt, cheese, and juices produced for the Romanian market. It will also support company's exports to international markets, including to Bulgaria and Greece.

The loan reflects the dual mandate of the BSTDB as a regional development institution to support the economic development of and the regional cooperation among the BSTDB Member Countries. It is expected to have a positive development impact through modernization and export capacity building and to promote regional trade and investment.

BSTDB Amount	**EUR 30 million**
Total operation cost	**EUR 55 million**
Type of financing	**Corporate loan**
Maturity	**7 years**

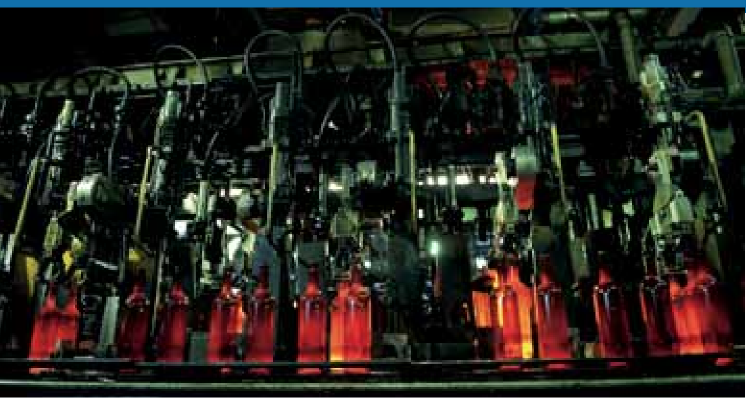
Outstanding Active Operations by Country

As of end-2012 the outstanding operations of the Bank (cumulative disbursements less repayments for active operations) represented EUR 785.9 million, distributed by country as depicted in the following graph:



Source: BSTDB

Selected BSTDB Financings in 2012



Glass Container Prim (Moldova)

The BSTDB provided a USD 3 million long-term loan to Glass Container Prim for the financing of a new glass packaging plant in Chisinau, Moldova. The modern manufacturing facility has an annual production capacity of up to 130 million high quality glass containers, bottles, and jars. Glass Container Prim has the flexibility to provide standard and exclusive products to its domestic and export clients.

The BSTDB loan was extended in parallel with a USD 10 million loan provided by the International Finance Corporation (IFC), following combined USD 16.6 million debt-equity swaps by the company's main shareholders. The BSTDB and IFC parallel loans were agreed in the framework of the Master Cooperation Agreement signed between the IFC and BSTDB in 2010.

The loan is part of the Bank's response to the development needs of the economy of Moldova, as reflected in BSTDB Country Strategy for Moldova, which emphasizes the need to finance projects directed at supporting local private businesses, with a particular focus on companies involved in food-processing and packaging sector.

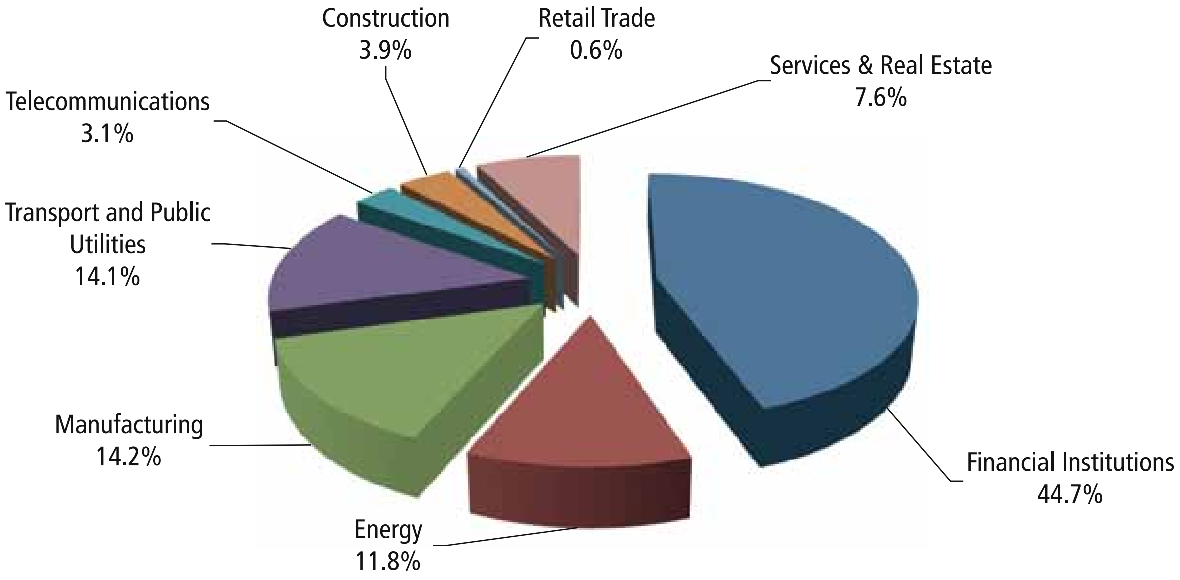
The operation is expected to have a positive development impact through transfer of modern technology and know-how to Moldova, employment creation, and support for the development of the agri-business sector of the country. The project is also expected to contribute to the further expansion of Moldova's trade with other BSTDB member states – Bulgaria, Romania, Russia, Turkey, and Ukraine.

BSTDB Amount	**USD 3 million**
Total operation cost	**USD 32.3 million**
Type of financing	**Project finance**
Maturity	**8 years**

Outstanding Active Operations by Sector

By sector, as at end-2012 there were outstanding 59 operations through financial institutions for EUR 351.3 million, 10 operations in energy for EUR 92.4 million, 8 operations in manufacturing for EUR 111.8 million, 8 operations in transport and public utilities for EUR 110.8 million, 3 operations in telecommunications for EUR 24.2 million, 4 operations in construction for EUR 30.4 million, 5 operations in services and real estate for EUR 59.8 million, and 2 operations in the retail trade for EUR 4.5 million.

The portfolio structure by sector shows good diversification. The number of operations in sectors with high development impact has increased. A large share of total portfolio in the financial sector is represented by trade finance and SME credit lines extended through financial intermediaries.



Source: BSTDB

Selected BSTDB Financings in 2012

BankPozitif SME Credit Line (Turkey)

BSTDB made available a EUR 20 million medium term senior loan to BankPozitif in Turkey for financing specific projects for job creation, modernization, capacity expansion, diversification of products and services, as well as working capital requirements of small and medium-sized enterprises (SMEs) in the country.

BSTDB gives strong emphasis to financing SMEs via financial intermediaries, considering that SME development is crucial for developing a vibrant private economy and for employment.

Established in 1999 as a non-deposit taking credit and development bank, BankPozitif provides boutique corporate banking services and technology-based retail lending products to its customers.

BSTDB Amount	**EUR 20 million**
Type of financing	**Credit line for SME finance**
Maturity	**5 years**

Portfolio Developments During 2012

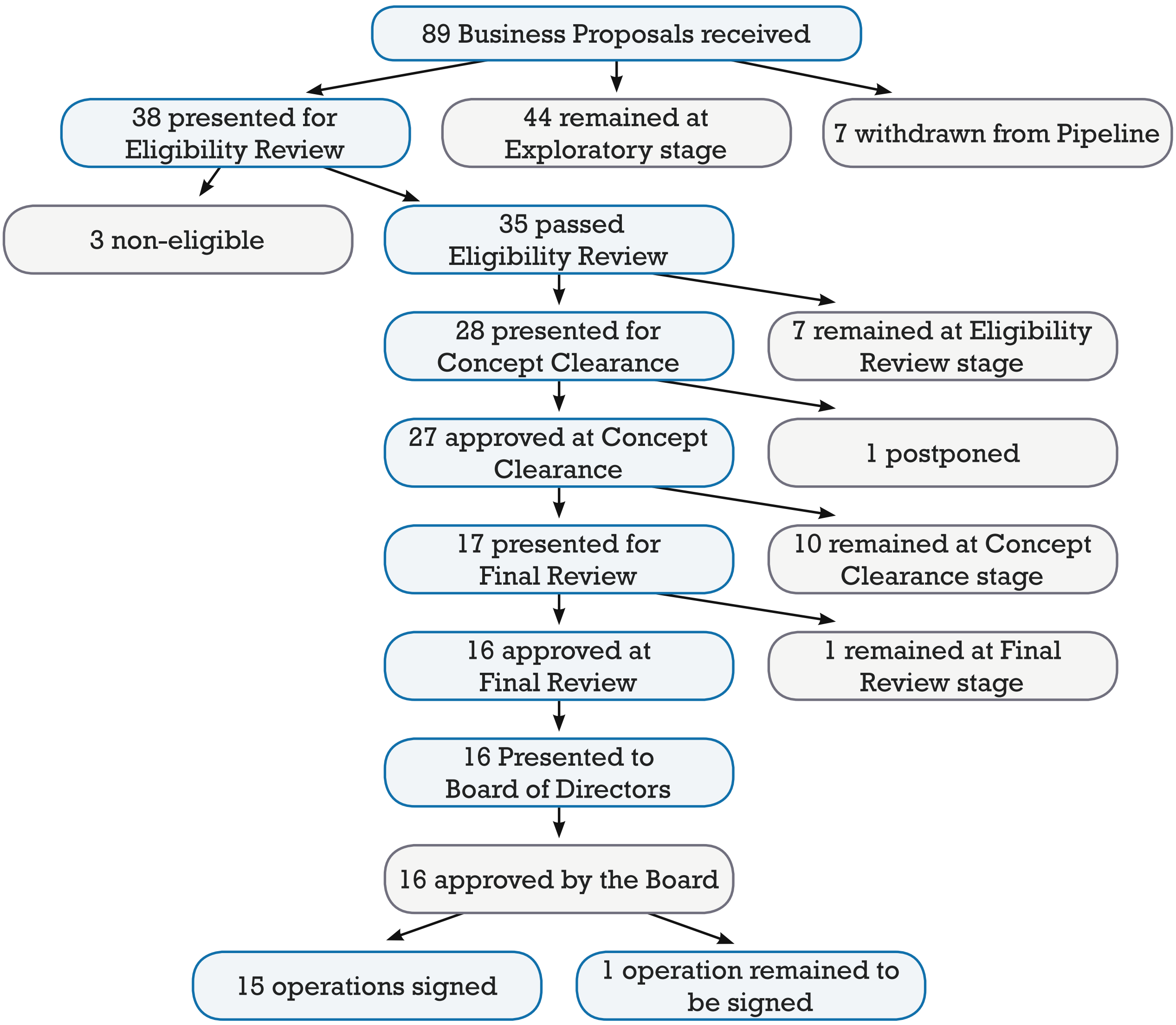
In 2012, the Board of Directors approved 16 new operations for a total of EUR 161.2 million. This was the result of business development effort, which resulted in the signing of 15 new operations for a total of EUR 168 million. At end 2012, the Bank had a total of 98 active borrowers.

During 2012, the Bank reviewed 89 business proposals, which went through different phases of the operations' cycle. Of these, 16 went through the entire operations cycle and got Board approval, along with other 22 operations which were identified and went through various phases of the operations cycle in 2012. 17 operations continued the appraisal process.

In terms of concentration, top 10 exposures represent 38.7% of total outstanding portfolio, and the next 10 largest exposures account for an additional 22% of the total outstanding amount.

Exposure to Financial Institutions sector comprised 44.7% of total outstanding portfolio. Exposure has historically been high due to the fact that BSTDB used financial institutions for a variety of purposes, including direct lending, SME and mortgage lines of credit, and trade finance. The other major sectoral exposure in the total outstanding portfolio was for manufacturing with 14.2%, transport and public utilities with 14.1%, and energy accounting for 11.8% of total outstanding amounts.

BSTDB Business Development in 2012



18% of the total Business Proposals is Board Approved
94% of the total Board approved operations is signed

Co-Financing

The Bank values its cooperation with other financiers in mobilizing investment in the Black Sea region and realizing cross-country operations. Such operations possess high shareholder value for the Bank and are therefore priority activities.

In 2012 the Bank co-financed the following operations:

1. Glass Container Prim in Moldova with EUR 2.27 million for a total amount of EUR 22.2 million with IFC and equity holders.
2. SEAF Caucasus Growth Fund Equity Investment in Armenia, Azerbaijan, and Georgia with EUR 7.58 million for a total amount of EUR 30.3 million with EBRD, IFC, FMO, and others.
3. TAV Izmir EGE Airport in Turkey with EUR 40 million for a total amount of EUR 250 million with EBRD and commercial banks.

The above co-financed projects represented 30% of the operations signed by BSTDB in 2012. The share of co-financed operations in the Bank's total outstanding portfolio exceeds 43%.

Selected BSTDB Financings in 2012

SEAF Caucasus Growth Fund Equity Investment (Armenia, Azerbaijan, Georgia)

In March 2012, BSTDB committed USD 10 million to the Small Enterprise Assistance Funds (SEAF) Caucasus Growth Fund. The SEAF Caucasus Fund will facilitate the access to affordable capital for competitive private businesses in Armenia, Azerbaijan, and Georgia and will foster good business practices and know-how transfer.

In establishing the SEAF Caucasus Fund, the Bank has partnered with the International Finance Corporation (IFC), the European Bank for Reconstruction and Development (EBRD), and the Netherlands Development Bank (FMO).

BSTDB and its partner international financial institutions committed at this stage USD 40 million to the fund, which has a target final size of USD 70 million.

This is the first institutional-quality fund dedicated to providing debt and equity capital to small and medium enterprises in Armenia, Azerbaijan, and Georgia.

Through their collaboration, the international financial institutions are supporting private equity investments in the small and medium enterprises segment, which is a backbone of the Caucasus economies and plays a key role in employment creation.

The Fund will invest across a range of industries, with particular focus on consumer and business services, agribusiness, distribution, energy, and retail, which remain underserved by other capital providers.

BSTDB Amount	USD 10 million
Total operation cost	USD 40 million (current Fund size)
Type of financing	Equity participation
Maturity	10 years

Special Funds

The Bank administers a special fund for technical assistance established in July 2001 by a Contribution Agreement between the Government of the Hellenic Republic and the BSTDB (the "Hellenic Fund"). The fund was set up with an initial amount of EUR 800,000 and was replenished with EUR 500,000 in 2003. The Hellenic Fund is tied to consulting companies based in Greece. However, up to 25% of an assignment cost may be allocated to consultants who are nationals of the Bank's other Member Countries. Altogether, the Hellenic Fund has disbursed since its inception around EUR 1,100,000 for 27 technical assistance assignments. These consultancy services were for companies in various sectors including manufacturing, telecoms, oil & gas, transportation, agribusiness, renewable energy, tourism, real estate, and banking. These funds were used for consultancy services in nine BSTDB member states - Albania, Armenia, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, and Ukraine. In 2012, the Fund financed the preparation of the business plan and financial model for a manufacturing company in Armenia and the due diligence support for a real estate project in Greece. The total amount disbursed by the Fund in 2012 for these assignments was about EUR 55,000.

The Bank also administers a technical cooperation special fund established in October 2008 with the Development Bank of Austria (the "Fund"). The OeEB contributed to the Fund an initial amount of EUR 500,000 provided by the Government of Austria as Official Development Assistance (ODA)[9]. The Fund is an untied facility offering financing for a wide range of technical assistance services related to project preparation and training needs of BSTDB clients. The Fund represents the first financial facility of this kind provided to the BSTDB by a non-regional institution. It can be used for assignments in the BSTDB Member Countries that are eligible for receiving ODA. In 2012, the Fund co-financed a pre-feasibility study for the development of the Model Highway Initiative of the International Road Transport Union (IRU) in the Black Sea Region. The purpose of the assignment was to identify the main criteria of the Model Highway Initiative and the financing mechanisms to enable its implementation. The study was co-financed with IRU and had a total cost of EUR 30,000.

Selected BSTDB Financings in 2012

Basisbank Trade Finance Credit Line (Georgia)

In April 2012 the Bank provided to Basisbank (Georgia) a USD 4 million short-term revolving trade finance facility to finance those sub-borrowers of Basisbank Georgia who have export sales or who import goods from BSTDB Member Countries.

The loan facility is aimed to improve the access to finance of Georgian exporting companies, including small and medium enterprises, and to facilitate imports from other BSTDB Member Countries. It also promotes job creation and income generation in the country.

The facility is expected to have a positive impact for the institutional development of Basisbank, resulting into additional business growth, improved liquidity, and client service.

Established in 1993, Basisbank is a stably growing financial institution with a firm base. It has a strong reputation of stability and high quality products and services. It has succeeded to build a large branch network and provides a full package of banking services for private and corporate customers.

BSTDB Amount	**USD 4 million**
Type of financing	**Credit line for trade finance**
Maturity	**Revolving facility with maturity of 360 days**

9 Official Development Assistance (ODA) – grants or concessional resources provided by official agencies for the promotion of economic development and welfare of developing countries included in the List of the Development Assistance Committee of the OECD. All Member Countries of the Bank are currently eligible for ODA, except for Bulgaria, Greece, Romania, and Russia.

Environment Protection

In 2012, the Bank continued to promote environmental soundness and sustainability principles in its Member States through the operations it financed. These comprised mainly Financial Intermediaries (FIs) transactions in which the Bank, among other issues, focused on the capability of its Clients to manage environmental risks and impacts associated with their business activity in a manner that is compliant with the requirements of the BSTDB Environmental Policy. This included assessment of the FIs environmental risk management policies and procedures, the level of integration into the overall portfolio management, portfolio analysis by environmental risk category, as well as the existing internal capacity to manage the associated environmental risks and impacts. In such operations, the Bank delegated the function and responsibility for environmental assessment to its Client FIs, which were required to ensure that the sub-borrowers financed from BSTDB proceeds comply with its policy requirements, national regulations and standards in effect, including environmental, health and safety, relevant International Conventions, and the BSTDB Negative List.

On the institutional side, the Bank started development of a new Environmental and Social Policy which will integrate environmental and social dimensions associated with its operations into the operation cycle.

Selected BSTDB Financings in 2012

Locko Bank SME Finance Credit Line (Russia)

BSTDB extended a USD 25 million loan to Locko Bank for financing small and medium enterprises in the Russian Federation. The loan contributes to expanding the SME lending program of one of the leading banks in the SME lending market in the country and represents an efficient instrument for BSTDB to support the development of small and medium sized businesses and entrepreneurs, who cannot be otherwise accessed by BSTDB via direct lending activities.

Locko Bank is a financial institution with sound financial and business records and a developed branch network which can easily be reached by Russian SMEs. The loan supports the development of SMEs which form the core of the country's economy and create additional employment opportunities for Russian citizens.

BSTDB Amount	**USD 25 million**
Type of financing	**Credit line for SME finance**
Maturity	**4 years**

Thus, in addition to the environmental issues, the Bank's internal due diligence will also cover social aspects, such as labor standards and working conditions, occupational health and safety, community health, safety and security, gender equality, cultural heritage, involuntary resettlement, and affordability of basic services. The new policy statement will be consistent with the best practices but at the same time tailored to meet the needs of BSTDB given its size, available resources, its unique mandate, and region of operation. The policy will be effective after Board of Directors, approval in 2013.

In terms of international cooperation, the Bank continued to work together with its counterparts in the area of development finance in the effort to further harmonize their environmental requirements. To emphasize its commitment to this process the Bank participates in a number of working groups such as Multilateral Financial Institutions (MFI) Working Group on Environment, European Development Finance Institutions Working Group on Environment and Social issues, as well as the Harmonization Initiative regarding development of core indicators.

Selected BSTDB Financings in 2012

Total Leasing SME Finance Credit Line (Moldova)

In June 2012, BSTDB signed a USD 5 million Loan to Total Leasing in Moldova for providing lease finance for SMEs. The facility aims to contribute to the growth of the SME business of one of the leading companies active in the leasing market in Moldova and to facilitate the access to finance for small and medium sized private businesses and entrepreneurs.

ICS Total Leasing S.A. was registered in 2006, and its main activity is to provide financial lease of motor vehicles and equipment to individuals and legal entities in Moldova. The company has a well known brand name in the sector and represents an excellent instrument for channeling medium term finance to small and medium sized businesses.

BSTDB Amount	**USD 5 million**
Type of financing	**Credit line for SME leasing**
Maturity	**5 years**

Use of Resources

Resources Management

Human Resources

Human resources are a key factor in the success of BSTDB, and the institution strives to maintain its status as a competitive employer following best international standards and practices, applying meritocratic recruitment, and a remuneration system that strives to promote excellence and positive incentives. Towards meeting these objectives, the HR Department has embarked on a systematic review and reform of HR policies and practices.

Human Resource Policy Development

In 2012, BSTDB entered the final stage of the HR Reform implementation, in support of the institutional goals as set out in the BSTDB Strategy. Revised policies were approved by the Board of Directors, covering the areas of recruitment and appointment, separation from service, and learning and development.

A revised performance management policy was formulated and presented to the Board of Directors. The revised policy features increased objectivity, introduces performance-related rewards, and links individual performance to the performance of the institution through a system of key performance indicators, which are cascaded down from the institutional to the departmental level and are an integral part in the calculation of individual performance scores.

The examination of the BSTDB basic salary scale and the classification system started in 2012. BSTDB considers possible modifications as a part of the formulation of a comprehensive remuneration policy, which would increase the fairness and transparency of human resources management and the institution's competitiveness in the labor market.

Staffing, Recruitment and Staff Development

BSTDB conducts recruitment on a wide geographical basis. While ceteris paribus preference is given to citizens from the member countries, recruitment is competitive and based on the professional qualifications of the candidates. At the end of 2012, BSTDB had a total of 105 employees, from 14 member and non-member countries.

BSTDB offers learning opportunities, addressing the development needs of its staff within the context of its organizational business requirements. In 2012, the majority of these opportunities focused on the development of professional and technical skills. A revised policy on training, learning, and development was adopted, establishing a clear link between the institution's business needs and staff development. Staff learning and development is also directly linked to the annual staff performance cycle.

Staff Benefit System

BSTDB operates a market-oriented staff compensation and benefits system designed to match the employment standards of other International Financial Institutions.

The BSTDB medical, life, and temporary incapacity / long-term disability insurance plan provides adequate coverage emphasizing preventive medical care. BSTDB also offers an optional post-separation medical coverage.

The BSTDB pension plan, launched in January 2003, is comprised of a fully funded defined benefit and a matched defined contribution component. This combination offers the flexibility crucial for best meeting the needs of a multi-national work force. In 2012, an increase of the maximum contribution rate to the defined contribution component was realized.

Information Technologies

Technology is a strategic tool to help increase the operational efficiency and administrative transparency and capacity of BSTDB. In line with the Bank's strategic objectives, the Information Technology (IT) Department strives to modernize and integrate the Bank's systems and to align business processes to international best practice.

Operations Cycle

The first phase of the Operations Cycle automation within the SAP system was finalized during 2012. This includes structured data on business partner information, project registration, the various stages of an operation from concept clearance, final review, board approval and signing, loan administration, and supervision and monitoring. The two modules used are the SAP Project System and the SAP Loans Administration. These two modules together with the Treasury Asset Liability Management module and the Consolidated Chart of Accounts form the integrated SAP Enterprise Resource Planning (ERP) system.

The SAP ERP system has appropriate in-built internal controls to secure data integrity and to allow for the automatic production of management and board reports, thus leading to improved management of operations. It further enables informed and up-to-date decision making at various organizational levels.

System Automation and Integration

During 2012, the Bank integrated the SAP ERP system with the Open Text's Extended Enterprise Content Management (xECM) for SAP, allowing information to be shared across systems. System integration provides flexibility in viewing and retrieving information from either system, and provides quick information access and improved monitoring of operations.

The second phase of the automation of the Operations Cycle within xECM was initiated in 2012. This phase allows for the automation of processes related to the production and approval of documents in different stages of the Operations Cycle, and for the application of record management.

The xECM system was upgraded to the latest version. The Enterprise Scanning feature of the upgraded xECM allows for the scanning of bulk paper documents into digital ones by assigning bar codes and classifications. Documents are stored in the xECM and the Archive Server for archiving, long term storage, and retrieval.

Registration of Business Inquiries

The Bank developed in-house a web-based application using the xECM system and Website software for the registration and management of all written inquiries related to business proposals.

This application provides the Banking Division with a tool to efficiently and effectively manage customer inquiries and correspondence. The application is linked with the SAP ERP system in case business proposals enter the operations pipeline.

Business Continuity

In order to secure the Bank's vital records and ensure seamless business continuity in the event of a disruptive natural or man-made event, the IT Department, during 2012, implemented a secured vital records management system and initiated the implementation of an enhanced disaster recovery site.

A professional, secure, offsite storage facility was identified in early 2012. All paper documents classified as Bank vital records were transferred to the offsite records storage facility by year end.

To enhance disaster recovery and business continuity, the Bank investigated a number of disaster recovery facilities within Europe and Asia. Following pre-qualification and a competitive process, a disaster recovery and business continuity site that meets all technical and business requirements was selected. Currently, the IT Department is in the process of finalizing the physical move to the new disaster recovery and business continuity site.

The Bank's virtual infrastructure was upgraded to the latest version for virtual servers and virtual desktops, allowing for higher degree of virtualization and commission of virtual desktops. In parallel, the firewall security software was updated, allowing enhanced security and providing users with secure remote access to Bank systems.

External Relations and Communications

The external relations and communications activities aim to support the BSTDB's strategy and achievement of corporate objectives by promoting institutional cooperation and increased awareness of the Bank in the region with governments, the international development community, partners, clients, and other stakeholders. To this end, during 2012, the External Relations and Communications department strived to improve the Bank's institutional relations and profile through target groups, contacts with the media, event organizing activities, the corporate website and publications, and information support to the Bank's operations.

Cooperation with Observer Institutions and Development Banks

During 2012, BSTDB strengthened institutional and business contacts with Observer Institutions and International Financial Institutions (IFIs) and development banks active in the Black Sea region with the view of sharing knowledge, attracting additional resources for development projects in the region, and promoting synergies.

An updated BSTDB Observer Status policy was prepared and approved by the Board of Governors. Policy updates help enhance the synergies with Observer Institutions and provide greater opportunities to improve the efficiency and development impact of Bank operations through project co-financing, and information exchange on best practices, capitalizing on the Bank's comparative advantages in the Black Sea Region.

In 2012, the Bank signed long-term loan agreements with KfW (Germany) and the Development Bank of Austria (OeEB), aimed to support private sector development and small and medium-sized enterprises (SMEs) in BSTDB member countries. Also, BSTDB cooperated with the International Finance Corporation of the World Bank Group (IFC) and the European Bank for Reconstruction and Development (EBRD) to establish equity funds supporting SME development in the Caucasus, Ukraine, and Moldova.

Multilateral Consultations

BSTDB has actively participated in multilateral consultation mechanisms established by IFIs to facilitate knowledge sharing aimed at increasing developmental effectiveness. In 2012, in Thessaloniki, BSTDB hosted annual meetings of the European Chief Compliance Officers of European International Financial Institutions and of the Chief Legal Officers of sixteen leading IFIs, as well as an international seminar of the IFIs Evaluation Cooperation Group on post evaluation systems.The Bank has also contributed to the IFI meetings of the Heads of Procurement and the Independent Accountability Mechanisms, the DFI Corporate Governance Working Group, and to the meetings of IFI Board Secretaries.

A joint report "International Finance Institutions and Development through the Private Sector", produced by 31 development institutions, was presented and discussed at the Business Forum hosted by the Bank on the occasion of its 14th Annual Meeting in Yerevan, Armenia. The report highlighted the significant role IFIs play in catalyzing private sector involvement by encouraging entrepreneurial initiatives that help growth and job creation.

BSTDB maintained information exchange and knowledge sharing in the framework of the Interact Group of the Association of the European Development Finance Institutions (EDFI). As a member of the Institute of International Finance (IIF), BSTDB contributed to the global discussion and coordination efforts on the financial and public debt crisis.

Institutional Support for Regional Cooperation

BSTDB maintained its strategic support for regional cooperation, contributing to the joint efforts of the Organization of the Black Sea Economic Cooperation (BSEC), Parliamentary Assembly of BSEC (PABSEC), and other BSEC family institutions. Close interaction with the Governments, Parliaments, business community, and academia of the countries of the Black Sea region represented by the BSEC family institutions, remained an important priority for the Bank. The Bank has contributed to the preparation of an updated BSEC Economic Agenda for the Future and to other BSEC policy documents on promoting regional cooperation. BSTDB maintained its involvement and support for BSEC project-oriented activities, including the BSEC initiatives of the Black Sea Ring Highway and Motorways of the Sea.

The Bank has continued cooperation with the International Road Transport Union (IRU) on the promotion of its Model Highway Initiative (MHI) for the Black Sea region. In March 2012, in Thessaloniki, BSTDB co-organized and sponsored a Workshop on investment, financial, and technological issues of MHI, together with BSEC and IRU. The pre-feasibility study on the MHI pilot section of Baku-Batumi-Trabzon was co-financed by BSTDB, using its Special Technical Assistance Fund provided by OeEB.

The Bank identified and explored cooperation opportunities with the United Nations Development Program's (UNDP) regional initiative for the Black Sea region to jointly promote trade and investment.

During the year, the Bank supported regional business events to promote the awareness of its development role and operations in member countries. The BSTDB President, senior management, and staff contributed to discussions held at regional fora, such as the Economic Summit of Serbia in Belgrade, and the South-East Europe Business Forum in Istanbul.

Financial Management

Business Volume

The Bank's total assets stood at EUR 983,583 thousand at end 2012 against EUR 836,831 thousand at end 2011 – an increase of 17%. The Bank's outstanding loan and equity portfolios totaled EUR 785,904 thousand compared to EUR 720,391 thousand in the previous year. Funds committed but not yet disbursed stood at EUR 106,859 thousand.

Revenues

Total income from lending activities increased to EUR 43,347 thousand for the year, from EUR 34,883 thousand in 2011. Treasury activities in 2012 generated total income of EUR 3,393 thousand from its available for sale and held to maturity portfolios. Operating income for the year was EUR 34,881 thousand compared to EUR 35,911 thousand in 2011. Although the Bank had a sharp revenue increase in core loan activities, the slight decrease in operating income derived from lower realized gains from the Bank's equity investments in relation to the previous year.

Expenses

Interest and similar expense for the year was EUR 14,964 thousand compared to EUR 12,110 thousand in 2011. This increase was due principally to the higher borrowing amounts required to fund increased lending activities.

Administrative expenses in 2012 including depreciation, were EUR 15,997 thousand, an increase of only EUR 333 thousand over the previous year. Administrative expenses include salaries, benefits, and other administrative costs.

Personnel expenses, to the amount of EUR 12,159 thousand, showed an increase of EUR 1,292 thousand from the previous year. Other administrative costs had a decrease from the previous year in to an amount of EUR 1,090 thousand.

Overall, administrative expenses were well within the 2012 Budget, reflecting the Bank's focus on budgetary discipline and effective cost controls.

Net Income

Income before impairment during the year was EUR 18,884 thousand compared to EUR 20,247 thousand in 2011. Total impairment losses to an amount of EUR 3,954 thousand were due to increased specific provision charges on operations, including an increased provisioning charge on debt investment securities held by the Bank.

The Bank posted net income of EUR 14,930 thousand for the year, an increase of 48% against the previous year. The quality of the lending portfolio remained sound, experiencing only one additional impaired loan operation.

Capital Base

Initial Share Capital

The initial authorized share capital of the Bank was SDR 1 billion divided into one million shares having a par value of SDR 1,000 each. Member States subscribed to all of the initial authorized share capital. Each of Armenia, Georgia, and Moldova voluntarily agreed to reduce its share from 2% to 1% in June 2004 leaving SDR 30 million unsubscribed. At the Board of Governors meeting in October 2008, it was decided that Azerbaijan would take up this 3% of unsubscribed shares. The additional subscription amount was fully paid in 2009.

New Share Capital

The Board of Governors decided in December 2007 to approve an increase to the Bank's authorized capital from SDR 1 billion to SDR 3 billion. They further approved SDR 1 billion increase in the capital to be subscribed by the existing Member States, thereby increasing subscribed capital to SDR 2 billion. An announcement that this additional SDR 1 billion was fully subscribed was made after the Board of Governors meeting in October 2008. Georgia declined to take up its 1% allocation, and this was taken up by Romania. Upon completion of the subscription, Greece, Russia, and Turkey remained the largest shareholders of the Bank with 16.5% stake each, followed by Romania with 14%, Bulgaria and Ukraine with 13.5% each, Azerbaijan with 5%, Albania with 2%, Armenia and Moldova with 1% each, and Georgia with 0.5% stake. In October 2011, Moldova reduced its portion of the subscribed capital from 1% to 0.5%, to which those shares were released to unallocated share capital.

The new subscribed capital will be paid according to the following schedule:

- Payment of the paid-in portion of the new subscribed capital, equivalent to 10% of the subscribed number of shares (totaling SDR 99 million) in cash by the Member States in 2010.
- Payment of the paid-in portion of the new subscribed capital, equivalent to 20% of the subscribed number of shares (totaling SDR 198 million), will be made by each Member State in eight equal successive annual installments between 2011 and 2018.

- The remaining callable portion of the new subscribed capital, equivalent to 70% of the shares (totaling SRD 693 million), represents a firm commitment on the part of the Member States to pay such amount when due in conformity with the relevant provisions of the Establishing Agreement.

As of 31 December 2012 the paid-in share capital was EUR 494.4 million.

The Board of Governors may also authorize additional subscriptions from the remaining SDR 1 billion of authorized capital in three instances:

- To satisfy demand for shares expressed by Member States.
- If in conformity with the provisions of Article 3 (Membership) of the Establishing Agreement, any BSEC Member State who is not yet a member of the Bank (currently Serbia) wishes to subscribe for BSTDB shares.
- If in conformity with the provisions of Article 3 (Membership) of the Establishing Agreement, a multilateral bank or financial institution expresses a desire to become a member.

Gearing Ratio

The Bank's institutional gearing ratio, the statutory limit on the total amount of ordinary operations (outstanding loans, equity investments, and guarantees) is 150% of the Bank's unimpaired subscribed capital, reserves, and surpluses, which at the end of 2012 stood at about EUR 3.7 billion.

The operational gearing ratio was set at 100% of the Bank's unimpaired paid-up capital, reserves, and surpluses and the usable portion of callable capital, which limits the total amount of operations to approximately EUR 2.2 billion.

Provisioning

Provisions are recorded in two ways:

- General provisioning rate applied to the entire portfolio.
- Specific provisions applied against certain assets and determined following an impairment test, carried out if evidence of credit deterioration is found during regular monitoring.

Starting with 2011, BSTDB has moved to a Basel II approach to include Loss Given Default and Discount Factors for security.

At the end of 2012, total provisions for loans stood at EUR 42,026 thousand, equivalent to 5.7% of the outstanding loan portfolio. The institutional target to be achieved for general provisions and reserves, over time, is set at 10% of total outstanding exposures, less the gross value of non-performing operations.

Furthermore, total provisions for debt investment securities stood at EUR 15,070 thousand, equivalent to 7% of the investment securities portfolio that was held by the Bank.

Reserves and Surplus

Reserves represent the internal generation of capital through the retention of earnings. Pursuant to the Bank's financial policies, reserves are the ultimate protection of the Bank's share capital against impairment resulting from credit losses, in excess of provisions, or losses due to market, operational, and compliance risks. The Bank targets a level of profitability guided by the desire to build an appropriate cushion of reserves against the risks inherent to its normal operations, and subsequently to grow its capital base consistent with its financial and growth objectives.

In addition to building up a cushion of reserves, the Bank also sets aside retained income to enable it to maintain the real value of its share capital funds, and increase its investment headroom through internally generated funds.

Market Risks

Market risk management is conducted within a framework of conservative risk limits and policy documents approved by the Board of Directors.

It is the policy of the Bank to take no significant interest rate or foreign exchange exposure. Asset and liability maturities and interest rate tenors are matched wherever possible.

Operational Risks

The Bank, like all financial institutions, is exposed to operational risks, defined as the risk of loss resulting from inadequate or failed internal processes, people, and systems, or from external events, which are risks other than those falling within the scope of credit and market risk. The definition includes legal risk but excludes strategic and reputational risk.

Appropriate measures are taken to achieve a high level of operational risk awareness and to enhance the operational risk management system. The Bank adopts market best practices and methods to manage and coordinate its operational risks. Key processes for the management of operational risk include, amongst others: (i) internal controls (e.g. the "four eyes principle", proper segregation of duties) within its offices and departments, (ii) the establishment of disaster recovery and business continuity plans that take into account different types of plausible scenarios to which the Bank may be vulnerable, (iii) the constant safe storage of the Bank's Vital Records, (iv) the purchase of corporate and property insurance policies to confront potential losses which may occur as a result of various events and natural disasters, and (v) the approval process of New Products to identify and assess the operational risk related to each new product, activity, process, and system.

The Bank utilizes the Standardized Approach (SA) as issued by the Basel Committee to monitor operational risk incurred[1] and the adequacy of its operational risk-related capital charges (Reserves).

Should the Bank quantify the operational risk embedded in its operations, it would, with the use of SA, amount to EUR 8.1 million for 2012 and EUR 7.4 million for 2011, constituting a fraction of the Bank's total reserves amount, which represents the ultimate protection of the Bank's capital against impairment resulting from credit losses in excess of provisions, or losses due to market, operational, and compliance risks. There is no general accepted methodology for calculating risks associated with compliance and other "black swan" type of events.

Based on the above quantified operational risk, it is deemed that the Reserves of the Bank are adequate to cover all potential losses arising from events of an operational risk nature, and because the Establishing Agreement requires the Bank to maintain reserves at a relatively high percentage of its portfolio[2], there is no need, for operational risk purpose, to make supplementary allocations.

Short Term Liquidity

As indicated in the statement of cash flows, the Bank's short term liquidity totaling EUR 200,727 thousand as of 31 December 2012 was invested in two types of money market instruments:

- Short-term deposits with institutions long term rated at a minimum of A2/A by either Moody's or Standard & Poor's credit rating agency.
- Euro commercial paper rated at a minimum short term A1/P1 by either Moody's or Standard & Poor's credit rating agency.

Investments are primarily denominated in EUR or USD currencies, and performance is monitored monthly against the Merrill Lynch 3 month Libid index.

The Banks liquidity ratio, calculated as liquid assets over 12 months net cash requirements including signed undisbursed commitments, stood at 1278% on 31 December 2012.

Borrowings Utilized

As of end 2012, the Bank had issued a four-year fixed rate bond for CHF 200,000 thousand and had swapped the proceeds, through the use of derivative instruments, into USD 209,534 thousand at a floating rate. The Bank had also signed loan agreements equivalent to EUR 108,692 thousand and USD 72,000 thousand. Outstanding Euro Commercial Paper issuance totaled USD 51,000 thousand at year end. As the size of the Bank's operations portfolio continue to increase, and taking into consideration its minimum liquidity requirements, the Bank might access sources of long term funds in 2013.

At 31 December 2012 the Bank had a long term investment grade credit rating from Standard and Poor's Investor Service of A and a short term rating of A1. The Bank also had a long term rating of A3 and a short term rating of P2 from Moody's Investor Service.

Risk Analysis

An independent financial analysis is performed for each of the Bank's operations. Corporate entities are initially subject to an assessment of creditworthiness based on historical financial statements. This is followed by cash flow modeling for the life of the proposed operation and stress testing of key assumptions. For financial institutions, risk analysis is based on quantitative methodology (i.e. capitalization, asset quality, liquidity, and foreign exchange risk) supported by comparisons of key ratios to industry standards.

[1] International Convergence of Capital Measurement and Capital Standards, a Revised Framework, June 2004

[2] No part of the net income or surplus of the Bank shall be distributed to Members by way of profit until the general reserves of the Bank shall have attained the level of ten (10%) percent of the subscribed capital including all paid, unpaid but payable, unpaid but callable capital. (Art. 36 – Allocation of Net Income).

Risk Mitigation

The Bank will normally require its operations to benefit from some form of security or risk-sharing in order to mitigate the credit risks involved. When the Bank lends to either public or private sector borrowers, it normally requires certain guarantees and, in all cases, ensures that the parties involved share risks in a reasonable manner.

Evaluation

The Bank conducts assessments of completed and current operations, programs, activities, and strategies through rigorous systematic analyses. This evaluation process serves two key objectives: (i) accountability – to reveal the results and impact of the Bank's operations and (ii) learning – to derive lessons learned from past experience, maintain a corporate memory, and enhance future performance.

Preferred Creditor Status

As an international financial institution, the Bank has preferred creditor status. This means that the Bank usually will:

- Not reschedule debt payments or participate in debt rescheduling agreements with respect to its loans to, or guaranteed by, its Member Countries of operations.
- Not reschedule its loans to private sector borrower where the borrower's inability or anticipated inability to service its debt is due to a general foreign exchange shortage in the borrower's country.

Corporate Governance

Management Structure

BSTDB is committed to maintaining effective corporate governance through a framework of responsibilities and controls. Transparency and accountability supported by clearly defined reporting systems enable maintenance of an appropriately controlled business environment.

BSTDB's governing constitution is set out in the Agreement Establishing the Bank. This document requires that the institution be managed by a Board of Governors, a Board of Directors, a President, Vice Presidents, a Secretary General, and such officers and staff, as may be necessary.

Each of the Member States of the Bank is represented on the Board of Governors. All powers of the Bank are vested in the Board of Governors. With certain exceptions, the Board of Governors has delegated the exercise of these powers to the Board of Directors, while still retaining overall authority.

The Board of Directors, chaired by the President of the Bank, is responsible for guiding the general operations of the Bank. Each of the Bank's Member States appoints a Director and an Alternate Director, with full powers to act for the Director when the Director is not present.

The Audit Committee is established by and reports directly to the Board of Directors. The composition of the Audit Committee is three Board of Director members, one being appointed as Chairman.

The President, as chief executive of the Bank, is its legal representative. In this capacity, and as Chairman of the Management Committee, he conducts the current business of the Bank under the direction of the Board of Directors. The President is appointed by the Board of Governors.

The Management Committee comprises of the President (as Chairman), three Vice Presidents, and the Secretary General. In the absence of the President, one of the Vice Presidents chairs the meetings of the Management Committee. The Vice Presidents and Secretary General are appointed by the Board of Directors on the recommendation of the President.

Compliance

The Compliance function of the Compliance and Operational Risk Management Office of the Bank assists management in effectively managing the compliance risks faced by the Bank. To this end, it identifies, assesses, advises on, monitors, and reports accordingly on the Bank's compliance risk.

With regard to the financing operations, anti-fraud, corruption, money laundering, and terrorism financing due diligence is – among other types of due diligence – integrated into the Bank's normal approval of new business and into the monitoring of existing activity. The Bank screens all transactions to ensure that they do not represent such risks. The Head of the Compliance function advised the business groups, upon their request, inter alia, on the Customer Due Diligence process and integrity issues.

Within 2012, the Bank's Anti-Fraud, Corruption, Money Laundering, and Terrorism Financing Policy together with the Know-Your-Customer Procedures were revised, reflecting international and International Financial Institutions' standards.

Reporting and Disclosure

BSTDB's corporate governance structure is supported by appropriate financial and management information reporting. Through its reports and disclosures, the Bank, in line with its policy of maintaining industry best practice, follows the reporting conventions of other international financial institutions. The Accounting Policies adopted by the Bank are in compliance with International Financial Reporting Standards.

With respect to external financial reporting, the Bank presents financial statements in its quarterly Summary Statements and in the Annual Report. Pursuant to Article 35 of the Establishing Agreement, these reports are transmitted to the Governments of the Member States (Annual Report only), members of the Board of Governors, and Directors and the BSEC Permanent International Secretary.

In its financial reporting, the Bank aims to provide appropriate information on risk and performance. Industry best practice guides the evolving disclosure practice both in public financial reports and management information reporting.

Internal Audit

Internal Audit is an independent, objective, assurance, and consulting activity that examines and evaluates the activities of the Bank as a service to management and the Board of Directors (primarily through its Audit Committee). The Audit Committee has the responsibility, inter alia, of satisfying itself that the internal audit process is adequate and efficient through reviewing the policy, scope, work program, and reporting relating to the Bank's internal audit.

According to the Bank's Internal Audit Charter, the internal Audit Department's main objective is to help management and the Board of Directors discharge their responsibilities and accomplish the objectives of the Bank by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes. The Internal Audit's mission is to foster an environment of continuous improvement in controls and risk awareness.

Enterprise Risk Management

Recognizing the need for effective internal controls and acknowledging that Enterprise Risk Management (ERM), including internal controls over financial reporting, is a fundamental approach for the management of an organization, the Bank has established a functioning, consolidated, and on-going Enterprise Risk Management system. This system includes certification in the Annual Report as to the effectiveness of internal controls over external financial reporting, using the standards and practices prescribed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), Internal Control Framework, and Enterprise Risk Management.

Upon the overall assessment of the effectiveness of internal controls over financial reporting, coordinated by the Internal Audit Department and a Working Group with representatives of all the Divisions of the Bank, an annual certification statement is issued, signed by the President and the Vice President Finance and subject to review and an attestation of the Bank's external auditors.

The external auditors review and offer their opinion on management's assertion as to the effectiveness of internal controls over financial reporting.

External Auditors

The External Auditors are appointed by the Board of Governors upon the recommendation of the Board of Directors. They are qualified outside auditors of international reputation and appointed for a term of one year, renewable further on such terms and conditions as approved by the Board of Directors.

The External Auditors' services are limited only to audit related services but may be subject to certain exceptions that are in the interest of the Bank. The performances and independence of the External Auditors are assessed by the Audit Committee.

In addition, the External Auditors review and offer their opinion on management's assertion as to the effectiveness of internal controls over financial reporting. This opinion is given as a separate report to the audit opinion. At the conclusion of their annual audit, the External Auditors prepare a management letter for the Board of Directors, which is reviewed in detail and discussed with the Audit Committee, setting out the External Auditor's views and management's response on the effectiveness and efficiency of internal controls and other matters.

Financial Statements and Notes

Financial Statements for the Year Ended 31 December 2012

Together with Auditor's Report

Internal Controls Over External Financial Reporting

Responsibility for external financial reporting

Management's responsibility

Management's report regarding the effectiveness of internal controls over external financial reporting

The management of the Black Sea Trade and Development Bank ("the Bank") is responsible for the preparation, integrity, and fair presentation of its published financial statements and all other information presented in this report. The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board.

The financial statements have been audited by an independent accounting firm, which has been given unrestricted access to all financial records and related data, including minutes of all meetings of the Board of Directors and committees of the Board. Management believes that all representations made to the external auditors during their audit were valid and appropriate. The external auditors' report accompanies the audited financial statements.

Management is responsible for establishing and maintaining effective internal controls over external financial reporting for financial presentations in conformity with IFRS. The system of internal controls contains monitoring mechanisms, and actions are taken to correct deficiencies identified. Management believes that internal controls for external financial reporting, which are subject to scrutiny and testing by management and internal audit and are revised as considered necessary, support the integrity and reliability of the financial statements.

There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and the circumvention of overriding controls. Accordingly, even an effective internal controls system can provide only reasonable assurance with respect to financial statements. Furthermore, the effectiveness of an internal controls system can change with circumstances.

The Bank's Board of Directors has appointed an Audit Committee, which assists the Board in its responsibility to ensure the soundness of the Bank's accounting practices and the effective implementation of the internal controls that management has established relating to finance and accounting matters. The Audit Committee is comprised entirely of members of the Board of Directors. The Audit Committee meets periodically with management in order to review and monitor the financial, accounting, and auditing procedures of the Bank and related financial reports. The external auditors and the internal auditors regularly meet with the Audit Committee, with and without other members of management being present, to discuss the adequacy of internal controls over financial reporting and any other matters which they believe should be brought to the attention of the Audit Committee.

The Bank has assessed its internal controls over external financial reporting for 2012. The Bank's assessment was based on the criteria for effective internal controls over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Based upon this assessment, management asserts that, at 31 December 2012, the Bank maintained effective internal controls over its financial reporting as contained in the Financial Statements for 2012.

The Bank's external auditors have provided an audit opinion on the fairness of the financial statements presented within this report. In addition, they have issued an attestation report on management's assessment of the Bank's internal controls over financial reporting.

Andrey Kondakov
President

Valentina Siclovan
Vice President Finance

Black Sea Trade and Development Bank
Thessaloniki
26 April 2013

Independent Reasonable Assurance

TO THE BOARD OF DIRECTORS AND GOVERNORS OF THE BLACK SEA TRADE AND DEVELOPMENT BANK

Report on the effectiveness of internal control over financial reporting

We were engaged by the Board of Directors of the Black Sea Trade and Development Bank to report on the effectiveness of the Black Sea Trade and Development Bank ("the Bank") internal control over financial reporting as of 31 December 2012 in the form of an independent reasonable assurance conclusion about whether the internal control over financial reporting is effective based on criteria established in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission ("the COSO criteria").

Bank's responsibilities

The Bank's management is responsible for maintaining effective internal controls over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying management's report.

Our responsibilities

Our responsibility is to express an opinion on the Bank's internal control over financial reporting based on the evidence obtained. We conducted our audit in accordance with the International Standard on Assurance Engagements (ISAE) 3000. That standard requires that we comply with ethical requirements, including independence requirements, and plan and perform our procedures to obtain reasonable assurance about whether the internal control over financial reporting is effective, in all material respects.

The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the effectiveness of internal control over financial reporting, whether due to fraud or error.

Our engagement also included obtaining an understanding of internal controls over financial reporting, evaluating the management's assessment and performing such other procedures as we considered necessary in the circumstances. Reasonable assurance is less than absolute assurance.

A bank's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles.

A bank's internal control over financial reporting include those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the bank; (2) provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with International Financial Reporting Standards, and that receipts and expenditures of the bank are being made only in accordance with authorizations of management and directors of the Bank; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the bank's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

Conclusion

We believe that the evidence we have obtained is sufficient and appropriate to provide a basis for our conclusion.

In our opinion, Black Sea Trade and Development Bank maintained, in all material respects, effective internal control over financial reporting, as of 31 December 2012, based on the COSO criteria.

26 April 2013

KPMG Certified Auditors A.E.
Athens, Greece

INCOME STATEMENT

For the year ended 31 December 2012

Presented in thousands of EUR	Note	2012	2011
Interest income	7	45,699	39,706
Interest expense	8	(14,964)	(12,110)
Net interest income		**30,735**	**27,596**
Net fees and commissions	9	1,041	433
Dividend income		0	1,250
Net profit on sale of equity investments		19	25
Net gains from available-for-sale equity investments	16	3,350	4,711
Net (losses) from debt investment securities		(245)	(18)
Net (loss) income on foreign exchange		(1)	1,033
Other (expense) income		(18)	881
Operating income		**34,881**	**35,911**
Personnel expenses	10,26	12,159	10,867
Other administrative expenses	10	3,309	4,399
Depreciation and amortization	19,20	529	398
Income before impairment		**18,884**	**20,247**
Impairment losses (gains) on loans	11	3,051	(4,591)
Impairment losses on equity investments		0	608
Impairment losses on guarantees	22	4	0
Impairment losses on debt investment securities	12	899	14,171
Net income for the year		**14,930**	**10,059**

The accompanying notes are an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2012

Presented in thousands of EUR	Note	2012	2011
Net income for the year		14,930	10,059
Other comprehensive income:			
Net change in fair value reserve (available-for-sale financial assets)	24	2,068	2,761
Exchange rate difference on conversion		0	(200)
Total comprehensive income for the year		**16,998**	**12,620**

The accompanying notes are an integral part of these financial statements.

STATEMENT OF FINANCIAL POSITION

At 31 December 2012

Presented in thousands of EUR	Note	2012	2011
Assets			
Cash and cash equivalents	25	18,227	11,888
Debt investment securities:			
Available-for-sale	12,13	17,963	26,528
Held-to-maturity	13,25	182,500	114,321
Derivative financial instruments – assets	14	11,517	0
Loans	15,17	742,614	688,218
Less: deferred income	15	(6,694)	(6,913)
Less: impairment losses	11	(42,026)	(39,843)
Loans net of impairment		693,894	641,462
Equity investments available-for-sale	16,17	43,290	31,565
Other assets	18	14,677	9,588
Property and equipment	19	699	555
Intangible assets	20	816	924
Total Assets		**983,583**	**836,831**
Liabilities			
Borrowings	21	373,355	268,084
Derivatives financial instruments – liabilities	14	0	8,746
Payables and accrued interest	22	9,105	3,051
Total liabilities		382,460	279,881
Members' Equity			
Authorised share capital	23	3,494,085	3,547,897
Less: unallocated share capital	23	(1,177,397)	(1,198,597)
Subscribed share capital	23	2,316,688	2,349,300
Less: callable share capital	23	(1,623,876)	(1,653,115)
Less: payable share capital	23	(198,094)	(228,767)
Cumulative translation adjustment	23	(337)	(216)
Advance against future call	23	11	15
Paid-in share capital		494,392	467,217
Reserves	24	44,206	40,103
Retained earnings		62,525	49,630
Total members' equity		601,123	556,950
Total Liabilities and Members' Equity		**983,583**	**836,831**
Off-balance-sheet items			
Commitments	17	106,859	171,967

The accompanying notes are an integral part of these financial statements.

STATEMENT OF CHANGES IN MEMBERS' EQUITY

For the year ended 31 December 2012

Presented in thousands EUR	Share capital: Subscribed	Share capital: Callable	Share capital: Payable	Reserves	Retained earnings	Total
At 31 December 2010	**2,324,580**	**(1,627,206)**	**(268,422)**	**30,996**	**46,117**	**506,065**
Total comprehensive income						
Net income for the year	0	0	0	0	9,859	9,859
Other comprehensive Income:						
Fair value reserve (available-for-sale financial assets)	0	0	0	2,761	0	2,761
Total comprehensive income	0	0	0	2,761	9,859	12,620
Transactions with owners, recorded directly in equity						
Members' contributions:						
Paid-in share capital	0	0	38,496	0	0	38,496
Cumulative translation adjustment	24,720	(25,909)	973	0	0	(216)
Advance against future call	0	0	(15)	0	0	(15)
General reserve	0	0	0	6,346	(6,346)	0
Total contributions by owners	24,720	(25,909)	39,454	6,346	(6,346)	38,265
At 31 December 2011	**2,349,300**	**(1,653,115)**	**(228,968)**	**40,103**	**49,630**	**556,950**
Total comprehensive income						
Net income for the year	0	0	0	0	14,930	14,930
Other comprehensive Income:						
Fair value reserve (available-for-sale financial assets)	0	0	0	2,068	0	2,068
Total comprehensive income	0	0	0	2,068	14,930	16,998
Transactions with owners, recorded directly in equity						
Members' contributions:						
Paid-in share capital	0	0	27,300	0	0	27,300
Cumulative translation adjustment	(32,612)	29,239	3,252	0	0	(121)
Advance against future call	0	0	(4)	0	0	(4)
General reserve	0	0	0	2,035	(2,035)	0
Total contributions by owners	(32,612)	29,239	30,548	2,035	(2,035)	27,175
At 31 December 2012	**2,316,688**	**(1,623,876)**	**(198,420)**	**44,206**	**62,525**	**601,123**

The accompanying notes are an integral part of these financial statements.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2012

Presented in thousands of EUR	Note	2012	2011
Cash flows from operating activities			
Net income for the year		14,930	10,059
Adjustment for:			
Impairment losses		3,954	10,188
Depreciation and amortization		529	398
Interest income		(7,703)	(7,258)
Interest expense		4,258	1,167
Realized gains on equity investments		(3,369)	(4,740)
Foreign exchange adjustment on provisions		(877)	(9,670)
Exchange rate difference on conversion		0	(1,041)
Operating income before changes in operating assets		11,722	(897)
Changes in:			
Derivative financial instruments		(11,693)	8,544
Other assets		(4,644)	(1,215)
Accounts payable		2,959	210
Deferred income		(219)	608
Fair value movements		1,469	(11,410)
Cash generated from operations		(406)	(4,160)
Proceeds from repayment of loans		153,449	190,062
Proceeds from repayment of equity investments		962	0
Proceeds from sale of equity investments		19	25
Funds advanced for loans		(215,269)	(214,132)
Funds advanced for equity investments		(9,184)	(13,743)
Foreign exchange adjustments		(1,712)	3,290
Interest income received		7,258	6,851
Interest expense paid		(1,167)	(1,905)
Net cash from / (used in) operating activities		(66,050)	(33,712)
Cash flows from investing activities			
Proceeds from available-for-sale investment securities		23,811	34,312
Purchase of available-for-sale investment securities		(15,245)	(3,894)
Purchase of property, software, and equipment		(565)	(832)
Net cash from / (used in) investing activities		8,001	29,586
Cash flows from financing activities			
Payments received from share capital		27,300	38,496
Decrease in advance against future call		(4)	(15)
Paid-in share capital received		27,296	38,481
Proceeds from borrowings		390,795	86,572
Repayments of borrowings		(285,524)	(116,742)
Net cash from / (used in) financing activities		132,567	8,311
Net increase in cash and cash equivalents		**74,518**	**4,185**
Cash and cash equivalents at beginning of year		126,209	122,024
Cash and cash equivalents at end of year	25	**200,727**	**126,209**

The accompanying notes are an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS

1. Establishment Of The Bank

Agreement Establishing the Bank

The Black Sea Trade and Development Bank ("Bank"), whose headquarters is located at 1 Komninon Street, Thessaloniki, in the Hellenic Republic, was established as an international financial organization under the Agreement Establishing the Bank dated 30 June 1994 ("Establishing Agreement"). In accordance with Article 61 of the Establishing Agreement, following establishment of the Bank the Establishing Agreement entered into force on 24 January 1997. The Bank commenced operations on 1 June 1999.

The purpose of the Bank is to accelerate development and promote cooperation among its shareholder countries. As a regional development institution it is well placed to mobilize financial resources and to improve access to financing for businesses in the whole region as well as for those active only in its individual Member Countries. The Bank offers project and trade financing facilities, equity participations, and guarantees. Bank financing of projects and programs is available directly or in cooperation with other national and international development institutions. The Bank may also, where appropriate, provide technical assistance to potential clients.

As at 31 December 2012 the Bank's shareholders comprised 11 countries: Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russian Federation, Turkey, and Ukraine.

Headquarters Agreement

The status, privileges, and immunities of the Bank and persons connected therewith in the Hellenic Republic are defined in the Headquarters Agreement between the Government of the Hellenic Republic and the Bank ("Headquarters Agreement") signed on 22 October 1998.

2. Basis Of Preparation Of Financial Statements

Statement of Compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as published by the International Accounting Standards Board ("IASB"). The financial statements for 2012 were submitted by the Management Committee to the Board of Directors ("BoD") for approval on 26 April 2013, and were approved on that date. Pursuant to Article 23 of the Establishing Agreement, these financial statements shall be subject to approval by the Board of Governors ("BoG") in their Annual Meeting to be held on 23 June 2013.

Basis of Measurement

The financial statements have been prepared on a historical cost basis except for those financial assets that have been measured at fair value. In addition, financial assets and financial liabilities subject to amortized cost measurement and which form part of a qualifying hedge relationship have been accounted for in accordance with hedge accounting treatment (see: "Derivatives" under this section). The Bank has not adopted any IFRS before their effective dates.

Functional and Presentation Currency

The Bank's functional currency is the Euro ("EUR") as defined by the European Central Bank ("ECB"). The Euro is most representative of the Bank's operations and environment as a significant percentage of the Bank's lending operations are in Euro, and the administrative expenses and capital expenditures are primarily denominated and settled in this currency. The Bank's presentation currency is the EUR.

In accordance with Article 4 of the Establishing Agreement, the Bank denominates its authorized share capital in the Special Drawing Right ("SDR") as defined by the International Monetary Fund ("IMF").

The value of the SDR is based on the weighted average of the values of a basket of major international currencies. Share capital which is paid is converted into the Bank's functional currency.

The Board of Governors of the Bank has adopted unanimously an amendment to the Establishing Agreement, which upon effectiveness will explicitly allow the BoG to change the unit of account of the Bank and re-denominate all authorized capital. The BoG has already determined that upon such effectiveness the unit of account of the Bank shall be the EUR, and all its authorized capital shall be denominated in EUR. Ten of the eleven Member States of the Bank have completed their internal juridical requirements for effectiveness, and the last remaining Member State has informed the Bank that it expects to do so within 2013.

Judgments and Assumptions

The preparation of the financial statements in conformity with IFRS requires management to make judgments and assumptions that affect the application of accounting policies and the reported amounts of assets and liabilities, income, and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Information about significant areas of estimations uncertainty and critical judgments in applying accounting policies that have the most significant effect on the amounts recognized in the financial statements are included in Note 4.

3. Significant Accounting Policies

Summaries of the Bank's significant accounting policies applied in the preparation of these financial statements are presented in this section. These policies have been consistently applied to all the financial periods being presented, unless otherwise indicated.

Foreign Currencies

Foreign currency transactions are initially recorded in EUR by applying to the foreign currency amount the exchange rate between the EUR and the foreign currency at the rate prevailing on the date of transaction. Exchange gains and losses arising from the translation of monetary assets and liabilities at the end-of-year exchange rates are recorded in the income statement.

The Bank uses the official exchange rates published for the EUR by the ECB, and uses the official exchange rate published for the SDR by the IMF for share capital installment obligations. Exchange rates used by the Bank at the financial position date were as follows.

			31 December 2012	31 December 2011
	=	United States dollar	1.31940	1.29390
	=	Pound sterling	0.81610	0.83530
1 EUR	=	Azerbaijan manat	1.03640	1.01739
	=	Romanian lei	-	4.32330
	=	Special drawing right	0.85782	0.84265

Recognition and Derecognition of Financial Instruments

The Bank recognizes a financial asset or financial liability in its statement of financial position when, and only when, it becomes a party to the contractual rights or obligations.

The Bank derecognizes a financial asset or a portion of financial asset when, and only when, it loses control of the contractual rights that comprise the financial asset or a portion of the financial asset. The Bank derecognizes a financial liability when, and only when, a liability is extinguished, that is when the obligation specified in the contract is discharged, cancelled, or expires. The evaluation of the transfer of risks and rewards of ownership precedes the evaluation of the transfer of control for derecognition transactions.

Cash and Cash Equivalents

For the purposes of the statement of cash flows, cash and cash equivalents consist of cash on hand, placements with other financial institutions, and debt securities with original maturities of three months or less. These are highly liquid assets that are readily convertible to a known amount of cash and are subject to insignificant risk in value.

Financial Assets

The Bank classifies financial assets in the following categories; loans and receivables, held-to-maturity investments, and available-for-sale financial assets. Their classification is determined at the time of initial recognition.

Held-to-maturity investments and available-for-sale financial assets are recognized on a trade date basis, which is the date the Bank commits to purchase or sell the asset. All loans are recognized when cash is advanced to borrowers at settlement date.

The Bank did not reclassify any non-derivative financial assets out of the fair value through profit or loss category in any particular circumstance. Nor did the Bank transfer any financial assets from the available-for-sale category to the loans and receivables category.

a) Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Third party expenses, such as legal fees, incurred in securing a loan, are treated as part of the cost of the transaction. Subsequently, loans are measured at amortized cost using the effective interest rate method less any provision for impairment or uncollectability. All revenues generated are reported in income.

b) Held-to-Maturity

Financial assets with fixed or determinable payments and fixed maturity dates are classified as held-to-maturity when the Bank has the positive intention and ability to hold to maturity. These financial assets are measured at amortized cost using the effective interest rate method, less any impairment in value. Amortized cost is computed as the amount initially recognized including the premium or discount that may arise on the date of acquisition, as well as transaction costs. Interest arising from these investments is reported in income.

c) Available-for-Sale

Financial assets such as equity investments or bonds classified as available-for-sale are intended to be held for an indefinite period of time, and may or may not be sold in the future. After initial recognition at cost, these financial assets are measured at fair value. The fair value of the available for sale securities that are traded in organized financial markets is determined by reference to quoted market bid prices. For those where there is no active market, the fair value is determined using accepted valuation techniques.

The unrealized gains and losses that arise from fluctuations in fair value are recognized as a separate component of equity until the financial asset is sold or derecognized for any other reason or until the investment is determined to be impaired, at which time, the cumulative gain or loss previously reported in equity is included in income. Foreign exchange gains or losses and any income accrued by using the effective interest rate method, for these assets, are recognized directly in income. Dividends received are included in income.

Financial Liabilities

Financial liabilities include borrowings and other liabilities.

a) Borrowings

Borrowing transactions are recognized in the statement of financial position at the time the funds are transferred to the Bank. They are initially stated at cost, which comprises the fair value of the funds transferred, less any transaction costs. In instances where the Bank uses derivative instruments to hedge the fair value of borrowing transactions, such borrowings are subsequently carried in the statement of financial position at fair value where the amortized cost value is adjusted to fair value by the hedged risks, with any changes in value recognized in income. Relevant interest expenses are reported in income using the effective interest rate method.

b) Other Liabilities

All other liabilities that are not derivatives or designated at fair value through profit or loss are recorded at amortized cost. The amounts include accrued finance charges on borrowings and other accounts payable.

Netting of Financial Assets and Liabilities

The netting off of assets and liabilities in the financial statements is permitted if, and only if, there is a currently enforceable legal right to offset the recognized amounts, and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously.

Derivatives

In the ordinary course of business, the Bank enters into various types of transactions that involve derivative financial instruments. A derivative financial instrument is a financial contract between two parties where payments are dependent upon movements in price in one or more underlying financial instruments, reference rates or indices.

Derivatives can include interest rate and cross currency swaps, forward foreign exchange contracts, interest rate future contracts, and options on interest rates and foreign currencies. Such financial instruments are initially recognized in the statement of financial position at cost and are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in fair value of derivatives are included in the income statement. Fair values are obtained from quoted market prices, to the extent publicly available, discounted cash flows, and options pricing models as appropriate.

a) Hedge Accounting

In order to manage particular risks, the Bank applies hedge accounting for transactions which meet specified criteria to debt securities that are issued by the Bank. A valid hedge relationship exists when a specific relationship can be identified between two or more financial instruments in which the change in value of one instrument (the hedging instrument) is highly negatively correlated to the change in value of the other (the hedged item). The Bank only applies hedge accounting treatment to individually identified hedge relationships on a one-to-one relationship.

To qualify for hedge accounting this correlation must be within a range of 80% to 125%, with any ineffectiveness within these boundaries or those which do not qualify as such, recognized in the income statement as fair value movement on non-qualifying and ineffective hedges under "net gains or losses at fair value on hedging activities."

The Bank documents the relationship between hedging instruments and hedged items upon initial recognition of the transaction. For cash flow hedges, the Bank also documents its assessment on an ongoing basis, of whether the derivatives that are used in hedging transactions are expected to be highly effective (on a prospective basis) in offsetting changes in fair values or cash flows of hedged items and demonstrate that it was effective (on a retrospective basis), for the designated period in order to qualify for hedge accounting.

If the hedging instrument expires or is sold, terminated, or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is discontinued prospectively. Any fair value adjustment is recognized immediately in the income statement.

i) Fair value hedge

Changes in the fair value of the derivatives that are designated and qualify as fair value hedges, and that prove to be highly effective in relation to hedged risk, are included in the income statement as fair value hedges under "net gains or losses at fair value on hedging activities," along with the corresponding change in fair value of the hedged asset or liability that is attributable to that specific hedged risk.

ii) Cash flow hedge

For designated and qualifying cash flow hedges, the effective portion of the cumulative gain or loss on the hedging instrument is initially recognized directly in reserves under "cash flow hedges." The ineffective portion, if any, of the gain or loss on the hedging instrument is recognized immediately in the income statement. Therefore, the movement in the fair value of cash flow hedges is recognized in reserves unless it is ineffective where that portion is transferred to the income statement as indicated above.

Impairment

An impairment loss for the Bank is the amount by which an asset's recorded carrying amount exceeds its expected recoverable amount.

a) Financial Assets Carried at Amortized Cost

For amounts due from loan and receivable portfolios, losses under guarantees, commitments, held-to-maturity, and other investments carried at amortized cost, the Bank first assesses whether objective evidence of impairment exists individually for those that are individually significant, or collectively for those that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed asset, whether significant or not, it includes the asset in a group of assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in a collective assessment of impairment.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest,
- Cash flow difficulties experienced by the borrower,
- Breach of loan covenants or conditions,
- Initiation of bankruptcy proceedings,
- Deterioration in the borrower's competitive position, and
- Deterioration in the value of collateral.

If there is objective evidence that an impairment loss has been incurred, that the Bank will not be able to collect all amounts due (principal and interest) according to original contractual terms, such assets are considered and classified as "non-performing." The amount of the loss is measured as the difference between the asset's carrying amount and the present value of expected future cash flows (excluding future credit losses that have not yet been incurred). The carrying amount of such an asset is reduced to its estimated recoverable amount through the use of an allowance for impairment account, and the amount of loss is recognized in income. Interest income continues to be accrued based on the original effective interest rate of the asset. The Bank ceases to accrue interest on those assets classified as non-performing for more than 90 days, or earlier when there is reasonable doubt as to actual collection, and for which the recoverable amount is determined primarily in reference to fair value of collateral.

An asset together with the associated allowance is written off when all or part of it is deemed uncollectible by liquidation, or all legal and other avenues for recover or settlement are exhausted, or in the case of debt forgiveness. Write-offs are charged against previously established allowances and reduce the principal amount of an asset. Whenever an amount of the estimated impairment loss increases because of an event occurring after the impairment was recognized, the previously recognized impairment loss is increased by adjusting the allowance account. Recoveries of such assets written off in earlier periods are included in income.

The present value of the estimated future cash flows is discounted at the asset's original effective interest rate as determined under the contract. If an asset has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate. The calculation of the present value of the estimated future cash flows of a collateralized asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

For the purpose of a collective evaluation of impairment, assets are grouped on the basis of the Bank's internal credit rating methodology that considers credit risk characteristics such as asset type, industry, and geographical location. From 31 December 2011, the Bank adopted a new basis for the purposes of collective evaluation of impairment, which was approved by the Board of Directors. The Bank's analysis, which was previously based on the banking systems in the BSEC countries, is currently based on the Global Emerging Markets ("GEMs") data base. The GEMs risk database standardizes the data collection process of member International Financial Institutions. The standardization process used by the Bank was also reviewed independently by Moody's Analytics. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any difference between loss estimates and actual loss experience.

Impairment losses for guarantees are applied when the guarantees are effective and based on their utilization. The methodology is consistent to that of loans, and such losses are included in "Other liabilities."

If the amount of impairment subsequently decreases due to an event occurring after a write-down, the release of the provision is credited to the provision for asset losses expense. Unwinding of the discount is treated as income, and remaining provision is then reassessed.

b) Available-for-Sale Financial Assets

At each financial position date, the Bank assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. For equity investments carried at fair value, a significant or prolong decline in the fair value below its cost is considered in determining whether the assets are impaired. If any such evidence exists, the cumulative impairment loss, which is measured as the difference between the acquisition cost and the current fair value, net of any impairment loss previously recognized in net income, is removed from reserves and included in income. Impairment losses, once recognized and included in income on these equity investments carried at cost, are not reversed.

For debt securities the Bank assesses at each financial position date whether there is objective evidence of impairment. The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Downgrading of the issuer below minimum eligibility levels for Treasury exposures,
- Issuer failure to pay amounts contracted under the security,
- Covenant breaches, default events, and trigger level failures,
- Deterioration of credit enhancement including diminution of collateral value, and
- Legal proceedings such as bankruptcy, regulatory action, or similar.

If any such evidence exists, the cumulative impairment loss measured as the difference between the acquisition cost and the current fair value is removed from reserves and included in income. If in a subsequent period the impairment indications of such securities cease to exist, related to an event after the impairment loss was recognized, that loss is reversed through income.

c) Non Financial Assets

At each financial position date, the Bank reviews the carrying value of the non financial assets and assesses whether there is any indication of impairment. If such indications exist, an analysis is performed to assess whether the book value of the specific assets can be recovered. The recoverable amount is the higher amount between the net value of sale (value of sale reduced by sale expenses) and of the value in use (as calculated from the net cash flows). If the carrying value of an intangible asset exceeds its recoverable value, then an impairment loss is recorded in income.

d) Renegotiated Loans

When necessary, the Bank seeks to restructure loans that may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due, but the impairment will remain for another two quarters to review the performance of the loan.

Risk Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. These loans continue to be subject to an individual impairment assessment, calculated using the loan's original effective interest rate.

Financial Guarantees

Issued financial guarantees are initially recognized at their fair value, being the premium (fee) received and subsequently measured at the higher of the unamortized balance of the related fees received and deferred, and the expenditure required to settle the commitment at the financial position date. The latter is recognized when it is both probable that the guarantee will require to be settled and that the settlement amount can be reliably estimated. Financial guarantees are recognized within other financial assets and other financial liabilities.

Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation. Depreciation is provided so as to write off the cost of each asset to their residual values on a straight-line basis over their estimated useful lives. The annual depreciation rates applied were as follows:

• Expenditure on leasehold buildings and improvements are depreciated over the remaining term of the lease	
• Transportation vehicles	20.0%
• Furniture and office accessories	20.0%
• Personal computers	33.3%
• Office and telecommunication equipment	20.0%

Intangible Assets

Intangible assets comprise software expenditures and other intangible assets. These assets are amortized on a straight-line basis over the best estimate of their useful lives, which is normally five years. Their carrying values are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Taxation

In accordance with Article 52 of the Establishing Agreement, the Bank, its assets, property, income, and its operations and transactions are exempt from all taxation and all customs duties in Greece. The Bank is also exempt from any obligation for payment, withholding, or collection of any tax or duty. Also, no tax shall be levied on salaries or emoluments paid by the Bank to employees. These tax exemptions are enforced by the Headquarters Agreement of Article 12, and have been implemented by the Greek Government by virtue of the ratification of Law 2380/No.38/7.3.1996.

Provisions

The Bank raise non-risk management provisions for potential obligations and risks when the following circumstances exist (a) there is an existing legal or constructive obligation as a result of past events, (b) for the obligation to be settled an outflow of resources embodying economic benefits is possible, and (c) a reliable estimate of the amount of the obligation can be made.

Share Capital and Dividends

In accordance with Article 36 of the Establishing Agreement, the Board of Governors shall determine annually what part of net income or surplus of the Bank from operations shall be allocated to reserves, provided that no part of the net income or surplus of the Bank shall be distributed to members by way of profit until the general reserves of the Bank shall have attained the level of ten (10%) per cent of the subscribed capital including all paid, unpaid but payable, and unpaid but callable share capital.

Reserves and Retained Earnings

In accordance with the Establishing Agreement of the Bank, the general reserve is created from the profits of the Bank for meeting any unforeseeable risks or contingencies.

The revaluation reserve represents the accumulated change in fair value of available-for-sale investments of the Bank, which have not been impaired.

The retained earnings of the Bank is the accumulated undistributed and unallocated net incomes over the years.

Revenues and Expenses

Interest income and expense are recorded in income for all interest bearing instruments on an accrual basis using the effective interest rate method based on actual contractual terms, with the exception being those assets that are individually identified as impaired, for which interest is recognized through unwinding the discount arising from the present value calculations applied to the expected future cash flows. The effective interest rate method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash flows (inflows and outflows) through the expected life of the financial instrument or, when appropriate, a shorter period to the carrying amount of a financial asset or financial liability.

In accordance with IAS 18, front-end fees and where applicable commitment fees pertaining to loans are amortized through income using the effective interest rate method over the life of the loans. This calculation however, does not include costs that any other party is directly responsible for as: taxes, notary fees, insurance, registration, etc. In the case of early repayment, cancellation, or acceleration, the outstanding deferred income from the related fees is recalculated taking into account the new maturity date. If the commitment expires without a loan being drawn down, the related fee is recognized as income on expiry.

Other commitment and guarantee fees and fees received in respect of services provided over a period of time are recognized as income on an accrual basis matching the period during which the commitment exists or the services are provided. Additionally, fees from negotiation, cancellation, arrangement, etc. are recognized on completion of the related transaction. Dividends are recognized when received. Administrative expenses are recorded on an accrual basis.

Staff Retirement and Termination Benefits

The Bank has established a pension plan, where the fund's assets are held separately from the Bank's own assets, for all its permanent employees, consisting of three pillars:

- The first pillar is a defined benefit scheme financed entirely by the Bank. The Bank's contributions are determined on the basis of actuarial valuations using the projected unit credit method, performed annually by qualified, independent actuaries. Actuarial gains and losses are recognized as income or expense when the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting year exceed 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognized over the expected average remaining working lives of the employees participating in the plan.
- The second pillar is a defined contribution scheme to which both the employee and the Bank contribute equally at a rate of 0–12% of basic salary. Each employee determines his/her contribution rate and the mode of investment of the contributions.
- The third pillar is a defined contribution scheme funded entirely by each employee, up to 40% of basic salary.

As an alternative, local staff are entitled to retirement benefits from the Greek State Social Insurance Fund ("IKA"), which is a defined contribution scheme.

Current service costs in respect of both the pension plan and IKA are recognized as an expense and included in "Personnel expenses."

The Bank may offer termination benefits to employees that are terminated before the normal retirement age. These indemnities, including any related retirement benefits, are recognized in income as an expense in the same period which they are incurred.

Government Grants

Government grants are recognized where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Grants relating to fixed asset expenditures are recognized in income on a straight-line basis over the same period as that applied for depreciation purposes. Those relating to administrative expenses are recognized in income matching with the expense incurred. The balance of grants received or receivable that has not been taken to income is carried in the statement of financial position within "Other liabilities."

Operating Leases – the Bank as a Lessee

For the Bank, an operating lease is a lease other than a finance lease. Under such agreements, all the risks and benefits of ownership are effectively retained by the lessor. The Bank has entered into this type of lease for its Headquarters building. Payments made under operating leases are charged to income on a straight-line basis over the period of the lease term. Any benefits received or that are receivable are also recognized on a straight-line basis over the lease term. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor, by way of penalty, is recognized as an expense in the period which the termination takes place.

New Accounting Standards and Interpretation of IASB

A number of new standards, amendments, and interpretations are effective for annual periods beginning after 1 January 2013, and have not been applied in preparing these financial statements. None of these is expected to have a significant effect on the financial statements of the Bank, except for IFRS 9 Financial Instruments, when it becomes mandatory for the Bank and could change the classification and measurement of financial assets. The Bank does not plan to adopt this or any other standard early, and the extent of the impact has not been determined.

For the 31 December 2012 financial statements the Bank has maintained the same policies as those stated in the latest annual financial statements.

New standards that are expected to have an effect on the Bank's financial statements are:

a) IAS 1 (Amendment) "Presentation of Financial Statements"

The amendment requires entities to separate items presented in other comprehensive income into two groups, based on whether or not they may be recycled to profit or loss in the future, and it is effective for annual periods beginning on or after 1 July 2012.

b) IFRS 9 "Financial Instruments"

This standard deals with the classification and measurement of financial asset and liabilities and is effective on 1 January 2015.

c) IAS 19 (Amendment) "Employee Benefits"

This amendment makes significant changes to the recognition and measurement of defined benefit pension expense and termination benefits and to the disclosures for all employee benefits. The amended standard is effective from 1 January 2013.

d) IFRS 13 "Fair Value Measurement"

IFRS 13 provides new guidance on fair value measurement and disclosure requirements and is effective from 1 January 2013.

4. Use of Judgement and Estimates

The preparation of financial statements involves management estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Consequently, the specific considerations regarding the use of management judgment in each area of estimate have been outlined in the respective accounting policy and disclosure note. The Bank's critical accounting judgments and estimates are as follows:

- Provisions for the impairment of loan operations. The Bank's method for determining the level of impairment of loan operations is described in the "impairment" accounting policy and further explained under "credit risk" of risk management. Portfolio provisions for loans not individually assessed as impaired amounted to EUR 8,824 thousand, as indicated in note 11.

  In determining the probabilities of default, the Bank applies a collective provisioning rate on the entire loan portfolio from the GEM's database, maintained by the European Investment Bank and the International Financial Corporation. This calculation formula of the GEM database takes into account Basel II criteria such as loss-given default and discount factor multipliers.

  An increase on specific provisions during the year was made for the identified impairment of EUR 5,445 thousand. Specific Provisions are assigned according to the degree of potential impairment resulting from the impairment test that is conducted on the basis of objective evidence obtained through a risk asset review process. An impairment test includes projected cash in-flows and out-flows, available for debt service until maturity, which are discounted at the effective rate to reach a net present value for a particular operation, less any collateral that can be realized. Impairment losses incurred from specific provisions are recognized to the income statement.

- Provision for impairment on debt investment securities. The Bank had impaired bonds issued by the Greek government as indicated in note 13.

- Staff retirement benefits. The Bank has established a pension plan for its staff which is described in "staff retirement and termination benefits" accounting policy and is detailed under staff retirement plan in note 26. The present value of retirement benefit obligations is sensitive to the actuarial and financial assumptions used, including the discount rate applied. At the end of each year, the Bank determines the appropriate discount rate and other assumptions to be used to determine the present value of estimated future pension obligations, based on interest rates of suitable long-term bonds and on currencies as the EUR and USD. The Bank's liability to the staff retirement plan at 31 December 2012 was EUR 759 thousand.

Actual results could differ from those estimates mentioned above, although such differences are believed not material and do not affect these financial statements.

5. Risk Management

Risk is inherent in the Bank's activities but is managed through an ongoing process of identification, measurement, and monitoring, and is subject to risk limits and controls. A conservative approach to risk taking together with effective risk management are critical to the Bank's continuing operations and profitability. The Board of Directors has approved risk management policies and guidelines that are delegated to the management of the Bank for the identification and control of risk.

The Bank's lending risk management policy documents describe the procedures for approval, management, and review of lending activity exposures. The Bank's Treasury investment policy documents define the risk parameters to be observed by the Treasury in managing its exposures. The Bank is exposed to risks identified in this section.

Financial Risk

The Bank's exposure to financial risk is through its financial assets and liabilities including any receivables from these financial assets. Two key aspects of financial risk are (i) credit risk and (ii) liquidity risk.

a) Credit Risk

The Bank is subject to credit risk, which is the risk that customers or counterparties will be unable to meet their obligations as they fall due. Credit risk arises principally from the Bank's lending activities. Regular reviews are conducted of all exposures within the lending portfolios, typically on a semi-annual basis, though exposures that are perceived to be more vulnerable to possible default are reviewed more frequently.

At each review there is (i) an assessment of whether there has been any change in the risk profile of the exposure, (ii) recommendations of actions to mitigate risk, and (iii) reconfirming or adjusting the risk ratings, and for equity investments, reviewing of fair value. Where relevant, the level of collective impairment or specific provision is evaluated and reconfirmed or adjusted. Responsibility for operations considered to be in jeopardy may be transferred from the original lending department to a corporate recovery team in order to most effectively manage the restructuring and recovery process.

Provision and reserve amounts are calculated each month using the Bank's IFRS compliant methodology, which as of 31 December 2011 uses a different source of information, the GEMs risk database (see section of the accounting policies: Impairment). The loan loss data is updated annually and provides objective evidence of impairment, using separately each operation's risk profile, adjusting it for current circumstances when necessary, upon which to estimate provisions of impairment.

For credit risks incurred by the Bank's Treasury in its investment and hedging activities, the Board of Directors has approved policies and guidelines for the determination of counterparty and investment exposure limits. The Bank's Risk Management assigns and monitors these counterparty and issuer credit risk limits. Treasury credit risks are also reviewed on a monthly basis by the Bank's Asset and Liability Committee.

The table below summarizes the maximum exposure to credit risk and indicates the worst-case scenario, without taking into consideration collateral, other credit enhancements, or provisions of impairment.

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Cash and bank balances	18,227	11,888
Debt investment securities	215,533	155,020
Derivative financial instruments	11,517	-
Loans	742,614	688,218
Equity investments	43,290	32,173
Other assets	14,677	9,588
On-balance-sheet	**1,045,858**	**896,887**
Undrawn commitments	106,859	171,967
Total	**1,152,717**	**1,068,854**

b) Analysis by Rating Agency

The tables below provide an analysis of financial investments in accordance with their Moody's rating as follows:

			2012			
Presented in EUR (000)	Aaa – Aa3	A1 – A3	Baa1 – Baa3	Caa1 – Caa3	Unrated	**Total**
Analysis by Moody's rating						
Cash and bank balances	18,227	-	-	-	-	**18,227**
Debt investment securities	-	182,500	12,430	20,603	-	**215,533**
Equity investments	-	-	-	-	43,290	**43,290**
At 31 December	**18,227**	**182,500**	**12,430**	**20,603**	**43,290**	**277,050**
Of which issued by						
Governments	-	-	-	20,603	-	**20,603**
Corporates	-	182,500	12,430	-	43,290	**238,220**
Deposits at banks	18,227	-	-	-	-	**18,227**
At 31 December	**18,227**	**182,500**	**12,430**	**20,603**	**43,290**	**277,050**
Of which classified as						
Available-for-sale	-	-	12,430	20,603	43,290	**76,323**
Held-to-maturity	-	182,500	-	-	-	**182,500**
Amortized cost	18,227	-	-	-	-	**18,227**
At 31 December	**18,227**	**182,500**	**12,430**	**20,603**	**43,290**	**277,050**

			2011			
Presented in EUR (000)	Aaa – Aa3	A1 – A3	Baa1 – Baa3	Caa1 – Caa3	Unrated	**Total**
Analysis by Moody's rating						
Cash and bank balances	11,888	-	-	-	-	**11,888**
Debt investment securities	-	114,321	21,229	19,470	-	**155,020**
Equity investments	-	-	-	-	32,173	**32,173**
At 31 December	**11,888**	**114,321**	**21,229**	**19,470**	**32,173**	**199,081**
Of which issued by						
Governments	-	-	8,680	19,470	-	**28,150**
Corporates	-	114,321	12,549	-	32,173	**159,043**
Deposits at banks	11,888	-	-	-	-	**11,888**
At 31 December	**11,888**	**114,321**	**21,229**	**19,470**	**32,173**	**199,081**
Of which classified as						
Available-for-sale	-	-	21,229	19,470	32,173	**72,872**
Held-to-maturity	-	114,321	-	-	-	**114,321**
Amortized cost	11,888	-	-	-	-	**11,888**
At 31 December	**11,888**	**114,321**	**21,229**	**19,470**	**32,173**	**199,081**

c) Collateral and Credit Enhancements

The Bank mitigates credit risk by holding collateral and other credit enhancements against exposure to customers and counterparties where it believes such security is necessary. The Bank defines security as mechanisms, procedures, and assets negotiated in transactions that are meant to protect it against loss in case of non-performance. Security includes, but is not limited to, material assets, financial instruments, covenants, and comfort letters.

- Loans and advances. The Board of Directors' approved guidelines for taking security under lending operations set the amounts and types of collateral and other credit enhancements. The main types of collateral that may be obtained by the Bank are: mortgages on properties and equipment, pledges of equity shares and investment instruments, assignment of rights on certain contracts, cash or blocked deposits, and other third party guarantees. When needed, the Bank reassesses the change in the market value of collateral and, if necessary, requests the pledging of additional collateral in accordance with the relevant agreement.
- Other financial instruments. Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Investment securities, treasury bills, and other eligible bills are generally unsecured. The Bank holds collateral against its derivative contracts.

d) Liquidity Risk

Liquidity risk concerns the ability of the Bank to fulfill its financial obligations as they become due, and is a measure of the extent to which the Bank may require funds to meet those obligations. The Bank's liquidity management is concentrated on the timing of cash in-flows and out-flows, as well as the adequacy of available cash and liquid securities. For this, the Bank estimates and relates all expected cash flows from assets and liabilities.

The Bank's commitment to maintaining a strong liquidity position is established in policies, approved by the Board of Directors, including a minimum liquidity ratio of 50% liquid assets to the next twelve months net cash requirements. The Bank's liquid assets are maintained in short-term placements and negotiable securities.

The table below presents the cash flows payable on financial liabilities placed into relevant maturity groups, based on the remaining period from the financial position date to the contractual maturity date. It indicates the earliest maturity dates that the Bank's counterparties have the ability to demand repayment. The figures represent undiscounted cash flows and therefore do not match to the statement of financial position.

Presented in EUR (000)	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	**Total**
Borrowings	-	1,400	91,546	299,649	15,408	**408,003**
Payables and accrued interest	-	5,347	3,758	-	-	**9,105**
Financial liabilities at 31 December 2012	**0**	**6,747**	**95,304**	**299,649**	**15,408**	**417,108**
Borrowings	-	122	173,343	99,529	11,467	**284,461**
Derivative financial instruments	-	8,746	-	-	-	**8,746**
Payables and accrued interest	-	2,210	841	-	-	**3,051**
Financial liabilities at 31 December 2011	**0**	**11,078**	**174,184**	**99,529**	**11,467**	**296,258**

For the Bank's financial assets, the majority mature from one year and over taking into consideration the latest possible repayment date.

Market Risk

Market risk refers to the probability of losses due to changes in the market prices of financial instruments, interest rates, and exchange rates. The Bank funds its operations by using its capital and by borrowing in the international capital markets. The Bank aims to match, wherever possible, the currencies, tenors, and interest rate characteristics of its borrowings with those of its lending portfolios. When necessary, the Bank uses derivative instruments to reduce its exposure to exchange rate and interest rate risk.

a) Foreign Exchange Risk

Exchange rate risk is the impact of unanticipated changes in foreign exchange rates on the Bank's assets and liabilities and any impact that could mirror on the income statement. The Bank monitors its assets and liabilities in order to ensure the Bank takes no significant foreign exchange risks. In doing so, the Bank matches, to the extent practicable, the lending obligations in any one currency, after swap activities, with liabilities in the same currency.

Furthermore, to avoid currency mismatches, borrowers are required to service their loans in the currencies disbursed by the Bank.

The effect of any currency fluctuations to the net exposure of the Bank is minimal. The tables below provide a currency breakdown of the Bank's assets and liabilities.

Presented in EUR (000)	Euro	United States dollar	Pound sterling	Other *	**Total**
Assets					
Cash and bank balances	14,619	3,592	7	9	**18,227**
Debt investment securities	203,103	12,430	-	-	**215,533**
Impairment losses on debt securities	(15,070)	-	-	-	**(15,070)**
Derivative financial instruments	11,517	-	-	-	**11,517**
Loans	339,431	403,183	-	-	**742,614**
Deferred income	(4,153)	(2,541)	-	-	**(6,694)**
Impairment losses on loans	(6,382)	(35,644)	-	-	**(42,026)**
Equity investments	16,991	6,777	-	19,522	**43,290**
Total	560,056	387,797	7	19,531	**967,391**
Liabilities					
Borrowings	114,574	258,781	-	-	**373,355**
Payables and accrued interest	6,271	2,834	-	-	**9,105**
Total	120,845	261,615	0	0	**382,460**
Net financial instruments	439,211	126,182	7	19,531	**584,931**
Derivative financial instruments	103,553	(103,553)	-	-	**0**
Currency balance at 31 December 2012	**542,764**	**22,629**	**7**	**19,531**	584,931

* Primarily represents the Access Bank equity investment which is denominated in Azerbaijan manats.

Presented in EUR (000)	Euro	United States dollar	Pound sterling	Other	Total
Assets					
Cash and bank balances	8,277	3,590	13	8	**11,888**
Debt investment securities	123,150	31,870	-	-	**155,020**
Impairment losses on debt securities	(14,171)	-	-	-	**(14,171)**
Loans	278,730	409,488	-	-	**688,218**
Deferred income	(3,779)	(3,134)	-	-	**(6,913)**
Impairment losses on loans	(4,961)	(34,882)	-	-	**(39,843)**
Equity investments	12,245	2,587	-	17,341	**32,173**
Impairment losses on equity investments	(183)	(425)	-	-	**(608)**
Total	399,308	409,094	13	17,349	**825,764**
Liabilities					
Borrowings	57,923	210,161	-	-	**268,084**
Derivative financial instruments	8,746	-	-	-	**8,746**
Payables and accrued interest	2,155	785	111	-	**3,051**
Total	68,824	210,946	111	0	**279,881**
Net financial instruments	330,484	198,148	(98)	17,349	**545,883**
Derivative financial instruments	211,021	(210,743)	-	(278)	**0**
Currency balance at 31 December 2011	**541,505**	**(12,595)**	**(98)**	**17,071**	545,883

b) Interest Rate Risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is determined on a financial instrument indicates to what extent it is exposed to interest rate risk. The Asset and Liability Management Unit monitors the interest rate exposure of the Bank.

The tables below provide information on the extent of the Bank's interest rate exposure based either on the contractual maturity date of the financial instruments or, in the case of instruments that re-price to a market rate of interest before maturity, the next re-pricing date as at the financial position date.

Presented in EUR (000)	Interest bearing				Non-interest bearing	Total
	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years		
Assets						
Cash and bank balances	18,225	-	-	-	2	**18,227**
Debt investment securities	90,000	94,000	-	31,533	-	**215,533**
Impairment losses on debt securities	-	-	-	-	(15,070)	**(15,070)**
Derivative financial instruments	-	-	-	-	11,517	**11,517**
Loans	113,529	315,357	274,407	39,321	-	**742,614**
Deferred income	-	-	-	-	(6,694)	**(6,694)**
Impairment losses on loans	-	-	-	-	(42,026)	**(42,026)**
Equity investments	-	-	-	-	43,290	**43,290**
Total	221,754	409,357	274,407	70,854	(8,981)	**967,391**
Liabilities						
Borrowings	26,906	27,947	146,010	172,492	-	**373,355**
Payables and accrued interest	-	-	-	-	9,105	**9,105**
Total	26,906	27,947	146,010	172,492	9,105	**382,460**
Derivative financial instruments	(160,492)	(12,000)	-	172,492	-	**0**
Interest rate risk at 31 December 2012	**34,356**	**369,410**	**128,397**	**70,854**	**(18,086)**	584,931

Presented in EUR (000)	Interest bearing: Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Non-interest bearing	**Total**
Assets						
Cash and bank balances	11,884	-	-	-	4	**11,888**
Debt investment securities	114,321	-	-	40,699	-	**155,020**
Impairment losses on debt securities	-	-	-	-	(14,171)	**(14,171)**
Loans	118,383	257,533	297,042	15,260	-	**688,218**
Deferred income	-	-	-	-	(6,913)	**(6,913)**
Impairment losses on loans	-	-	-	-	(39,843)	**(39,843)**
Equity investments	-	-	-	-	32,173	**32,173**
Impairment losses on equity investments	-	-	-	-	(608)	**(608)**
Total	244,588	257,533	297,042	55,959	(29,358)	**825,764**
Liabilities						
Borrowings	-	57,908	210,176	-	-	**268,084**
Derivative financial instruments	-	-	-	-	8,746	**8,746**
Payables and accrued interest	-	-	-	-	3,051	**3,051**
Total	0	57,908	210,176	0	11,797	**279,881**
Interest rate risk at 31 December 2011	**244,588**	**199,625**	**86,866**	**55,959**	**(41,155)**	**545,883**

c) Sensitivity Analysis

The Bank's interest rate sensitivity analysis comprises of two elements. Firstly, there is the differential between the interest rate the Bank earns on its assets and the cost of borrowing to fund these assets. For this element the Bank does, as closely as possible, match interest rate periods, thus minimizing sensitivity. Secondly, there is the absolute rate earned on assets that are funded by the Bank's equity resources. The majority of these equity resources are currently invested in the Bank's loan portfolio at floating rates; therefore, subjecting earnings on equity resources to some degree of fluctuation. As the Bank matures and its financial position grows, it is the intention that earnings on equity resources be stabilized by an increased investment in fixed rate instruments.

The table below details the re-pricing gap by currency. A parallel upward or downward shift in the EUR curve of 50 basis points would have generated the maximum loss or gain respectively.

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Euro	225,600	162,900
United states dollar	109,200	28,700
Romanian lei	-	(100)
Total re-pricing gap	334,800	191,500
Shift of 50 basis points in the EUR curve	**1,674**	**958**

Operational Risk

The Bank defines operational risk as all aspects of risk related exposure other than those falling within the scope of financial and market risk. This includes the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events and legal risk. The Bank has a low tolerance for losses arising from the operational risks it is exposed to.

Where any such risks are identified, appropriate mitigation and control measures are put in place. The Bank's operational risk management focuses on proactive measures to mitigate the operational risk.

Classification and Fair Value

The tables below identify the Bank's financial assets and liabilities in accordance with IAS 39 categories.

Presented in EUR (000)	At 31 December 2012				
	Held-to-maturity	Loans and receivables	At amortized cost	**Carrying Amount**	**Fair Value**
Assets					
Cash and bank balances	-	-	18,227	**18,227**	**18,227**
Debt investment securities	182,500	-	-	**182,500**	**182,500**
Loans	-	742,614	-	**742,614**	**742,614**
Deferred income	-	-	(6,694)	**(6,694)**	**(6,694)**
Impairment losses on loans	-	(42,026)	-	**(42,026)**	**(42,026)**
Other assets	-	14,677	-	**14,677**	**14,677**
Total financial assets	**182,500**	**715,265**	**11,533**	**909,298**	**909,298**
Liabilities					
Borrowings	-	-	373,355	**373,355**	**373,355**
Payables and accrued interest	-	-	9,105	**9,105**	**9,105**
Total financial liabilities	**0**	**0**	**382,460**	**382,460**	**382,460**

Presented in EUR (000)	At 31 December 2011				
	Held-to-maturity	Loans and receivables	At amortized cost	**Carrying Amount**	**Fair Value**
Assets					
Cash and bank balances	-	-	11,888	**11,888**	**11,888**
Debt investment securities	114,321	-	-	**114,321**	**114,321**
Loans	-	688,218	-	**688,218**	**688,218**
Deferred income	-	-	(6,913)	**(6,913)**	**(6,913)**
Impairment losses on loans	-	(39,843)	-	**(39,843)**	**(39,843)**
Other assets	-	9,588	-	**9,588**	**9,588**
Total financial assets	**114,321**	**657,963**	**4,975**	**777,259**	**777,259**
Liabilities					
Borrowings	-	-	268,084	**268,084**	**268,084**
Payables and accrued interest	-	-	3,051	**3,051**	**3,051**
Total financial liabilities	**0**	**0**	**271,135**	**271,135**	**271,135**

a) Fair Value Hierarchy

The Bank held the below financial instruments measured at fair value, and uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: Quoted market prices in active markets for identical assets or liabilities,
- Level 2: Other techniques for which all inputs that have a significant effect on the recorded fair value are observable, either directly or indirectly, and
- Level 3: Techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

The tables below identify the Bank's financial instruments measured at fair value.

Presented in EUR (000)	Level 1	Level 2	Level 3	Carrying Amount
Available-for-sale:				
Debt investment securities	33,033	-	-	**33,033**
Equity investments	-	-	43,290	**43,290**
Derivative financial instruments	-	11,517	-	**11,517**
At 31 December 2012	**33,033**	**11,517**	**43,290**	**87,840**

Presented in EUR (000)	Level 1	Level 2	Level 3	Carrying Amount
Available-for-sale:				
Debt investment securities	40,699	-	-	**40,699**
Equity investments	517	-	31,656	**32,173**
Derivative financial instruments	-	(8,746)	-	**(8,746)**
At 31 December 2011	**41,216**	**(8,746)**	**31,656**	**64,126**

b) Classification

Investment securities classified as "available for sale" include government and corporate bonds; their fair value has been determined using quoted prices.

Investment securities classified as "held to maturity" include European commercial papers and notes with an initial maturity lower than 12 months; they are carried at amortized which is estimated to be their fair value due to their short term nature. No market prices are available.

Equity investments classified as "available for sale" include investments that are not quoted on an exchange (i.e. private equity), the fair value of which has been estimated with techniques that use inputs not based on observable market data.

c) Fair Value Measurement in Level 3

The table provides a reconciliation of the fair values of the Bank's Level 3 financial assets of the fair value hierarchy.

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
At 1 January	31,656	16,968
Total gains or losses for the year recognized in the income statement	-	-
Total gains or losses recognized in other comprehensive income	1,469	2,761
Purchases, sales, issues, and settlements	10,165	11,927
Transfers into or out of level 3	-	-
Total	**43,290**	**31,656**

Capital Management

The Bank's initial authorized share capital was SDR 1 billion, which is fully subscribed by the shareholding states. In December 2007, the Board of Governors approved an increase of the Bank's authorized share capital to SDR 3 billion and authorized the offering of SDR 1 billion to the existing Member States for subscription, with the objective of increasing subscribed capital to a total of SDR 2 billion. This increase will allow the Bank to implement its operational strategy to a substantial degree. The Bank does not have any other classes of capital.

In October 2008 the above new shares in the amount of SDR 1 billion that were offered for subscription to the Bank's shareholding states were fully subscribed and allocated. Accordingly, the Bank's paid-in share capital was doubled from SDR 300 million to SDR 600 million. The remaining SDR 1 billion of authorized share capital has not yet been allocated.

The capital usage of the Bank is guided by statutory and financial policy parameters. Article 15 of the Establishing Agreement limits the total amount of outstanding loans, equity investments, and guarantees made for ordinary operations to 150% of the Bank's unimpaired subscribed capital, reserves, and surpluses, establishing a 1.5:1 institutional gearing ratio. Additionally, disbursed equity investments shall not at any time exceed an amount corresponding to the Bank's total unimpaired paid-in capital, surpluses, and general reserve. At the 36th meeting of the Board of Directors in 2008, the operational gearing ratio was set at 100% of the Bank's unimpaired paid-up capital, reserves, and surpluses, and the usable portion of the callable capital. This limit on the total amount of operations which includes all callable capital is approximately SDR 1.9 billion (EUR 2.2 billion).

The Bank preserves an actively managed capital to prudently cover risks in its activities. As a multilateral financial institution, the Bank is not subject to regulatory capital requirements. However, the Bank uses standards proposed by the Basel II Capital Accord as a benchmark for its risk management and capital framework. Pursuant to Article 5 of the Establishing Agreement, the Board of Governors shall at intervals of not more than five years review the capital stock of the Bank. In substance, the primary objective of the Bank's capital management is to ensure adequate capital is available to support the Bank's operations.

6. Segment Reporting

The Bank is a multilateral financial institution dedicated to accelerating development and promoting cooperation among its shareholder countries. The Bank operates in a specific geographical area and the primary reporting format for business segments includes Lending and Treasury operations. Lending activities represent investments in projects such as loans, equity investments, and guarantees, which in accordance with the Establishing Agreement, are made to accelerate development and promote co-operation among the Bank's shareholder countries. Treasury activities include raising debt finance, investing surplus liquidity, and managing the Bank's foreign exchange and interest rate risks.

Presented in EUR (000)	2012			2011		
	Lending	Treasury	Total	Lending	Treasury	Total
Income statement						
Interest income	42,306	3,393	45,699	34,452	5,254	39,706
Net fees and commissions	1,041	-	1,041	431	2	433
Total segment revenues	43,347	3,393	46,740	34,883	5,256	40,139
Less: interest expense	(14,383)	(581)	(14,964)	(11,924)	(186)	(12,110)
Net fair value, foreign exchange and other	3,369	(264)	3,105	6,871	1,011	7,882
Less: personnel and other admin. expenses	(14,424)	(1,044)	(15,468)	(14,219)	(1,047)	(15,266)
Less: depreciation and amortization	(527)	(2)	(529)	(330)	(68)	(398)
Segment income before impairment	17,382	1,502	18,884	15,281	4,966	20,247
Less: impairment (losses) release	(3,055)	(899)	(3,954)	3,983	(14,171)	(10,188)
Net income for the year	**14,327**	**603**	**14,930**	**19,264**	**(9,205)**	**10,059**
Financial position						
Segment assets	753,376	230,207	983,583	684,094	152,737	836,831
At end of year			**983,583**			**836,831**
Segment liabilities	382,460	-	382,460	271,135	8,746	279,881
Members' equity	-	-	601,123	-	-	556,950
At end of year			**983,583**			**836,831**

The geographical segment reporting of the Bank is presented in the following note "Operational analysis."

7. Interest Income

Interest and similar income is analyzed as follows:

Presented in EUR (000)	Year to 31 December 2012	Year to 31 December 2011
From loans	39,663	31,633
From placements with financial institutions	8	25
From investment securities available-for-sale	643	1,436
From investment securities held-to-maturity	2,677	3,009
From derivative financial assets at fair value	65	784
From front-end fees and commitment fees	2,643	2,819
Interest and similar income	**45,699**	**39,706**

8. Interest Expense

Interest and similar expense is analyzed as follows:

Presented in EUR (000)	Year to 31 December 2012	Year to 31 December 2011
From borrowed funds	7,570	5,254
From issued debt	5,919	6,105
From derivative financial liabilities at fair value	510	71
From amortized issuance and arrangement costs	894	596
From other charges	71	84
Interest and similar expense	**14,964**	**12,110**

9. Net Fees and Commissions

Net fees and commissions are analyzed as follows:

Presented in EUR (000)	Year to 31 December 2012	Year to 31 December 2011
Guarantee fees	2	-
Management fees	196	187
Appraisal fees	-	11
Administration fees	11	-
Arrangement fees	600	-
Surveillance fees	20	-
Prepayment/cancellation fees	197	153
Participation fees	-	(74)
Other	15	156
Net Fees and commissions	**1,041**	**433**

10. Personnel and Other Administrative Expenses

Administrative expenses are analyzed as follows:

Presented in EUR (000)	Year to 31 December 2012	Year to 31 December 2011
Salaries and benefits	10,220	9,277
Staff retirement plan	1,939	1,590
Personnel expenses	**12,159**	**10,867**
Professional fees and related expenses	426	1,229
Utilities and maintenance	1,309	1,303
Other administrative	1,574	1,867
Other administrative expenses	**3,309**	**4,399**

11. Impairment Losses On Loans

Loans are stated net of provisions. A summary of the movements in provisions for impairment were as follows:

Presented in EUR (000)	Collective	Specific	Total
At 31 December 2010	21,265	22,069	43,334
Charge for the year	-	5,371	5,371
Release for the year	(9,962)	-	(9,962)
Foreign exchange adjustments	85	1,015	1,100
At 31 December 2011	11,388	28,455	39,843
Charge for the year	-	5,445	5,445
Release for the year	(2,394)	-	(2,394)
Foreign exchange adjustments	(170)	(698)	(868)
At 31 December 2012	**8,824**	**33,202**	**42,026**

As of 31 December 2011 the Bank adopted a new basis for the purpose of collective evaluation of impairment, which was approved by the Board of Directors. The Bank's collective impairment evaluation, which was previously based on the banking systems in the BSEC countries, is currently based on the Global Emerging Markets ("GEMs") data base. The GEMs risk data base standardizes the risk rating and data collection process of member International Financial Institutions. The Bank's rating scorecards which determine operation risk levels were developed by the Bank with the assistance of Moody's Analytics.

At 31 December 2012 the Bank categorized three non-performing loans and two sub-standard loans as impaired with an exposure amount of EUR 68,937 thousand (2011: EUR 48,415 thousand), and the provision on these assets amounted to EUR 33,202 thousand (2011: EUR 28,455 thousand), as collateral held is estimated not to have significant value.

12. Impairment Losses On Debt Investment Securities

A summary of the movements for impairment losses of available-for-sale debt investments is as follows:

Presented in EUR (000)	Total
At 31 December 2011	14,171
Charge for the year	899
At 31 December 2012	**15,070**

13. Debt Investment Securities

Debt investment securities are analyzed as follows:

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Government bonds	20,603	28,150
Corporate bonds	12,430	12,549
Commercial papers	182,500	114,321
Debt investment securities	215,533	155,020
Less: impairment losses	(15,070)	(14,171)
Debt investment securities net of impairment	**200,463**	**140,849**

The Bank's bonds are classified within the available-for-sale portfolio, and commercial papers are classified within the held-to-maturity portfolio.

In 2012, the Hellenic Republic initiated and completed through the introduction via legislation of collective action clauses a bond swap ("PSI") in respect of certain series of bonds, including bonds held by the Bank. The Bank had purchased the original bonds that had a nominal value of EUR 20,000 thousand, at EUR 19,470 thousand. These were replaced in the PSI via the activation of such collective action clauses with new bonds having a nominal value of EUR 9,300 thousand. The "acquisition cost" of these replacement Hellenic government bonds was the fair value of the bonds at the exchange rate:

Presented in EUR (000)	
Nominal value of original bonds	20,000
Discount received	(530)
Acquisition cost	19,470
Prior year impairment loss	(14,171)
Current year impairment loss recognized in the income statement	(899)
Fair value of new bonds	**4,400**

The above government bond is further analyzed as follows:

			Cumulative fair value gain (loss)		At 31 December 2012
Presented in EUR (000)	Nominal value	Acquisition cost	Income statement	Other comprehensive income	Fair Value
Hellenic Republic	9,300	4,400	-	1,132	5,532

14. Derivative Financial Instruments

The table below shows outstanding forward foreign exchange contracts the Bank had engaged. The first column shows the sum of notional amounts, which is the amount of a derivative's underlying asset, and is the basis upon which changes in the value are measured.

Presented in EUR (000)	At 31 December 2012		At 31 December 2011	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Currency swap purchases	106,500	106,500	202,275	202,275
Currency swap sales	(103,634)	(103,553)	(211,808)	(211,021)
Designated as fair value hedges	-	8,570	-	-
Derivative financial instruments	**2,866**	**11,517**	**(9,533)**	**(8,746)**

15. Loans

The Bank offers a range of loan facilities directed to investments for both project and trade financing, tailored to meet an individual operation's requirements. Loans may be denominated in any convertible currency or a combination of convertible currencies in which the Bank is able to fund itself.

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
At 1 January	688,218	654,746
Disbursements	215,269	214,132
Less: repayments	(153,449)	(190,062)
Foreign exchange movements	(7,424)	9,402
Loans total	742,614	688,218
Less: deferred income	(6,694)	(6,913)
Less: impairment losses	(42,026)	(39,843)
Loans net of impairment	**693,894**	**641,462**

The Bank classifies loan facilities as either standard, overdue, doubtful, or non-performing. Non-performing are those that are primarily impaired and which associated interest is not being accrued.

As of 31 December 2012 all loan facilities are classified as standard and there were five that were impaired.

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Individually impaired	68,937	48,415
Less: allowance for impairment	(33,202)	(28,455)
Carrying amount	35,735	19,960
Collectively impaired	673,677	639,803
Less: allowance for impairment	(8,824)	(11,388)
Carrying amount	664,853	628,415
Past due but not impaired	-	-
Neither past due nor impaired	-	-
Total carrying amount at amortized cost	**700,588**	**648,375**

Interest is generally based on Libor for USD loans and Euribor for EUR loans plus a margin. Margins are dependent on the risk category of each loan and typically range from 1.5% to 8.0%. The fair value of the loan portfolio is approximately equal to carrying value plus accrued interest as all loans bear a variable interest rate and are given at market terms and conditions. Further analysis of the loan portfolio is presented in note "Operational analysis."

16. Equity Investments

A primary focus of the Bank is to facilitate access to funding for those small and medium size enterprises with the potential for positive economic developmental impact. With this objective in mind, the Bank, together with a number of other institutions, invested in the entities as detailed below.

Presented in EUR (000)	% of Investment	At 31 December 2012 Cost	At 31 December 2012 Fair Value	At 31 December 2011 Cost	At 31 December 2011 Fair Value
SEAF Caucasus Growth Fund	25.00	2,356	2,212	-	-
Access Bank, Azerbaijan	20.00	16,403	19,522	13,328	16,824
Transgaz Romania	0.72	-	-	419	517
Balkan Accession Fund	9.09	7,589	6,271	7,226	6,792
A-Park Kaluga, Russia	19.99	1,714	2,694	1,714	1,467
Emerging Europe Accession Fund	8.40	315	6	188	188
Rusal	0.01	4	203	4	208
ADM Ceecat Recovery Fund	5.65	8,178	8,019	4,106	3,798
European Virgin Fund	21.05	4,799	4,363	2,379	2,379
Available-for-sale total		41,358	43,290	29,364	32,173
Less: impairment losses		-	-	-	(608)
Equity investments net of impairment			**43,290**		**31,565**

The valuation of such investments, which are unlisted, has been estimated using the most recent management accounts or the latest audited accounts as of 31 December 2012, as management considers that is the best available estimate of the investments' fair value.

The increase of EUR 1,932 thousand since the acquisition of the investments was due to an unrealized gain in fair value, attributable to the Bank's participation.

During the year, the Bank had realized a net income of EUR 3,350 thousand from its investment in the Access Bank by way of increase in share value instead of receiving dividends in cash.

The Bank has a committed amount of EUR 24,012 thousand towards the above entities share capital, which as of 31 December 2012 has not been called-up. Further analysis of the equity investment portfolio is presented in note "Operational analysis."

As at 31 December 2012, the Bank has only three equity investments where it holds slightly more than 20 per cent of the investee share capital but does not exert significant influence, hence the investment is not accounted for as an investment in an associate under IAS 28.

17. Operational Analysis

The analysis of operational activity of the Bank by geographical area, instrument and sector are presented below:

Presented in EUR (000)	At 31 December 2012		At 31 December 2011	
	Outstanding disbursements	Undrawn commitments	Outstanding disbursements	Undrawn commitments
Analysis by instrument				
Loans	742,614	66,847	688,218	130,012
Equity investments	43,290	24,012	32,173	25,955
Guarantees *	-	16,000	-	16,000
At end of year	**785,904**	**106,859**	**720,391**	**171,967**
Analysis by country				
Albania	42,563	-	50,250	3,478
Armenia	31,196	1,061	32,332	-
Azerbaijan	76,476	5,699	40,499	22,184
Bulgaria	72,863	-	66,121	21,000
Georgia	15,572	27,536	22,877	17,082
Greece	43,516	-	47,724	-
Moldova	15,040	758	21,064	4,000
Romania	45,000	-	20,517	20,000
Russia	190,940	8,562	162,241	35,082
Turkey	155,028	32,978	158,051	-
Ukraine	76,840	6,253	85,558	23,186
Regional	20,870	24,012	13,157	25,955
At end of year	**785,904**	**106,859**	**720,391**	**171,967**
Analysis by sector **				
Financial institutions	323,842	34,051	292,211	62,805
Energy and infrastructure	110,956	22,253	129,479	59,185
General industries***	351,106	50,555	298,701	49,977
At end of year	**785,904**	**106,859**	**720,391**	**171,967**

* Trade finance guarantees primarily represent stand-by letters of credit issued in favor of confirming banks that have undertaken the payment risk of issuing banks. Other guarantees include unfunded full or partial risk participations.

** The sector analysis is based on per Banking Team responsibilities.

*** Also includes transport and tourism.

The Bank is restricted to operating in its 11 Member States, and individual country limits are set as a maximum at 30% of approved commitments. This limit is calculated on the basis of the Board of Directors approved operations, minus repayments and cancellations. Individual operations are further constrained by the Single Obligor Limit and by monitoring of Sectoral Exposure.

Operations are monitored according to a schedule prepared by the Bank's Risk Management Department, in conjunction with the originating Banking Teams. Monitoring reports are completed by the Bank's Project Implementation and Monitoring Department based on financial analysis prepared by the Financial Analysis Department. Risk asset reviews, based on the mentioned monitoring reports, are performed by the Risk Management Department and may result in a downgrade or upgrade of an operation's status and, if a significant deterioration is noted, trigger an impairment test.

18. Other Assets

Other assets is analyzed as follows:

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Accrued interest	7,703	7,258
Advances and prepaid expenses	2,791	1,149
Other prepayments	237	236
Pending pension plan payment	2,999	-
Rental reimbursement receivable	875	875
Guarantee deposits	72	70
Other assets	**14,677**	**9,588**

19. Property And Equipment

Property and equipment is analyzed as follows:

Presented in EUR (000)	Buildings (leasehold)	Vehicle	Furniture and office accessories	Computers and office equipment	Total
Cost					
At 31 December 2010	194	68	497	1,433	2,192
Additions	3	95	57	287	442
Disposals	-	(68)	-	(11)	(79)
At 31 December 2011	197	95	554	1,709	2,555
Additions	140	-	56	184	380
Disposals	-	-	-	(5)	(5)
At 31 December 2012	**337**	**95**	**610**	**1,888**	**2,930**
Accumulated depreciation					
At 31 December 2010	190	49	451	1,214	1,904
Charges	3	33	24	115	175
Disposals	-	(68)	-	(11)	(79)
At 31 December 2011	193	14	475	1,318	2,000
Charges	11	19	29	177	236
Disposals	-	-	-	(5)	(5)
At 31 December 2012	**204**	**33**	**504**	**1,490**	**2,231**
Net book value					
At 31 December 2012	**133**	**62**	**106**	**398**	**699**
At 31 December 2011	4	81	79	391	555
At 30 December 2010	4	19	46	219	288

20. Intangible Assets

Intangible assets comprising computer software are analyzed as follows:

Presented in EUR (000)	Total
Cost	
At 31 December 2010	2,609
Net additions	390
At 31 December 2011	2,999
Net additions	185
At 31 December 2012	**3,184**
Accumulated amortization	
At 31 December 2010	1,837
Charges	238
At 31 December 2011	2,075
Charges	293
At 31 December 2012	**2,368**
Net book value	
At 31 December 2012	**816**
At 31 December 2011	924
At 30 December 2010	772

21. Borrowings

Borrowing facilities arranged at end of the year are analyzed below. In addition to medium or long-term borrowings, the Bank utilizes short-term financing in the form of borrowings from commercial banks for cash management purposes. At December 2012 the Bank has issued debt securities in the amount of EUR 211,145 thousand.

Presented in EUR (000)	At 31 December 2012		At 31 December 2011	
	Amount used	Borrowings arranged	Amount used	Borrowings Arranged
Euro	114,574	174,574	57,923	148,923
United States dollar	93,224	146,278	210,161	210,161
Swiss franc	165,557	165,557	-	-
Total	**373,355**	**486,409**	**268,084**	**359,084**

The Interest rate on borrowings falls within a range of Euribor or USD Libor of +0 to +300 points. There is no collateral against the above borrowed funds. The fair value of the borrowings is approximately equal to their carrying value.

22. Payables and Accrued Interest

Payables and accrued interest is analyzed as follows:

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Accrued interest	4,258	1,167
Social insurance fund (IKA) contributions	29	31
Pension plan obligation	759	841
Suppliers and other accrued expenses	1,056	1,012
Pending pension plan payment	2,999	-
Other	4	-
Payables and accrued interest	**9,105**	**3,051**

23. Share Capital

In accordance with Article 4 of the Establishing Agreement, the initial authorized share capital of the Bank is one billion SDR divided into one million shares having a par value of one thousand SDR each. The authorized capital stock of the Bank may be increased at such time and under such terms as may seem advisable.

The Bank's capital stock is divided into paid-in shares and callable shares. Payment for the paid-in shares subscribed to by members is made over a, or similar to, period of years in accordance with Article 6 of the Establishing Agreement or as determined in advance by the Bank. The same Article states that payment of the amount subscribed to the callable shares is subject to call only as and when required by the Bank to meet its obligations.

Under Article 37 of the Establishing Agreement, any member may withdraw from the Bank by transmitting in writing to the Bank at its Headquarters. Withdrawal by a member shall become effective and its membership shall cease on the date specified in its notice, but in no event less than six months after such notice is received by the Bank. However, at any time before the withdrawal becomes finally effective, the member may notify the Bank in writing of the cancellation of its notice of intention to withdraw. Under Article 39 of the Establishing Agreement, after the date on which a member ceases membership, it shall remain liable for its direct obligations to the Bank and also remain responsible for its contingent liabilities to the Bank, incurred as of that date. No member has ever withdrawn its membership, nor has any ever indicated to the Bank it might do so. Were a member to withdraw from the Bank, at the time a member ceases membership, the Bank shall arrange for the repurchase of such a member's shares by the Bank as part of the settlement of accounts with such a member and be able to impose conditions and set dates pursuant to the same Article 39 of the Establishing Agreement. Any amount due to the member for its shares shall be withheld so long as the member, including its central bank or any of its agencies, has outstanding obligations to the Bank, which may, at the option of the Bank, be applied to any such liability as it matures. If losses are sustained by the Bank on any guarantees or loans which were outstanding on the date when a member ceased membership and the amount of such losses exceeds the amount of the reserves provided against losses on the date, the member concerned shall repay, upon demand, the amount by which the repurchase price of its shares would have been reduced if the losses had been taken into account when the repurchase price was determined.

Under Article 42 of the Establishing Agreement, in the event of termination of the operations of the Bank, the liability of members for the unpaid portion of the subscribed capital of the Bank shall continue until all claims of creditors, including all contingent claims, have been discharged.

All participating members had fully subscribed to the initial authorized share capital in accordance with Article 5 of the Establishing Agreement. Subsequently, at the Sixth Annual Meeting of the Board of Governors held on 6 June 2004, three Member States, Armenia, Georgia, and Moldova requested a fifty per cent reduction of their portion of subscribed capital, from 2% to 1% of the initial authorized capital, and the Board of Governors approved their request. On 5 October 2008, the new shares offered in the same structure as the initial authorized share capital, in the amount of SDR 1 billion, were fully subscribed by the Member States. Furthermore, Azerbaijan also subscribed to the 3% of the initial authorized share capital that remained unallocated, while Romania subscribed both to their allocation of new shares and to those of Georgia. This subscription process followed a decision taken by the Board of Governors in December 2007 to triple the Bank's authorized capital to SDR 3 billion and to double the subscribed capital to SDR 2 billion, while leaving authorized capital of SDR 1 billion unallocated. On October 2011, the Board of Governors approved the request from Moldova to a fifty per cent reduction of its portion of subscribed capital, from 1% to 0.5%, and those shares were released to unallocated.

The above share capital both in SDR and EUR equivalent is analyzed as follows:

Presented in EUR (000)	At 31 December 2012		At 31 December 2011	
	SDR	EUR	SDR	EUR
Authorized share capital	3,000,000	3,494,085	3,000,000	3,547,897
Less: unallocated share capital*	(1,010,000)	(1,177,397)	(1,010,000)	(1,198,597)
Subscribed share capital	1,990,000	2,316,688	1,990,000	2,349,300
Less: shares not yet called	(1,393,000)	(1,623,876)	(1,393,000)	(1,653,115)
Less: shares called but not yet due	(156,939)	(182,950)	(177,269)	(210,371)
Less: shares called and past due	(12,991)	(15,144)	(15,502)	(18,396)
Called-up share capital	427,070	494,718	404,229	467,418
Cumulative translation adjustment	-	(337)	-	(216)
Advance against future call	10	11	12	15
Paid-in share capital	**427,080**	**494,392**	**404,241**	**467,217**

* Shares available to new or existing Member States.

The translation gains or losses on share capital which is callable and payable are credited or debited to the "Cumulative translation adjustment" to duly reflect the fluctuations of the SDR value of the members' equity.

Initial Capital

In accordance with paragraph 2 under Article 5 of the Establishing Agreement, the initially authorized capital stock was subscribed by and issued to each Member as follows: 10% (SDR 100 million) fully paid and 20% (SDR 200 million) payable by promissory notes or other obligations which are not negotiable and non interest bearing in eight equal successive annual installments in the years 1998-2005.

Capital Increase

The capital increase of SDR 1 billion is divided into SDR 300 million paid in capital and SDR 700 million callable capital. Pursuant to the Board of Governors decision in October 2008, the SDR 300 million paid-in portion is divided into 10% (SDR 100 million) fully paid shares in 2010 and 20% (SDR 200 million) payable shares by promissory notes or other obligation issued by such member in eight equal successive annual installments in the years 2011 to 2018. As of October 2011, the capital increase was reduced by SDR 10 million of the subscribed share capital.

The initial and capital increase that was issued is analyzed as follows:

Presented in SDR (000)	At 31 December 2012		
	Initial Capital	Capital Increase	**Total**
Authorized share capital	1,000,000	2,000,000	**3,000,000**
Less: unallocated share capital	(30,000)	(980,000)	**(1,010,000)**
Subscribed share capital	970,000	1,020,000	**1,990,000**
Less: shares not yet called	(679,000)	(714,000)	**(1,393,000)**
Less: shares called but not yet due	-	(156,939)	**(156,939)**
Less: shares called and past due	-	(12,991)	**(12,991)**
Called-up share capital	291,000	136,070	**427,070**
Advance against future call	35	(25)	**10**
Paid-in share capital	**291,035**	**136,045**	**427,080**

Statement of Subscriptions

A statement of capital subscriptions illustrating the number of shares and the amount subscribed by each member is shown below, including their respective callable, payable, and the amount paid. The capital subscription status at 31 December 2012 is analyzed as follows:

Member	Shares	Subscribed	Callable	Payable	Paid
		Presented in SDR (000)			
Albania	40,000	40,000	28,000	6,000	6,000
Armenia	20,000	20,000	14,000	1,500	4,500
Azerbaijan	100,000	100,000	70,000	7,500	22,500
Bulgaria	270,000	270,000	189,000	20,250	60,750
Georgia	10,000	10,000	7,000	-	3,000
Greece	330,000	330,000	231,000	25,441	73,559
Moldova	10,000	10,000	7,000	-	3,000
Romania	280,000	280,000	196,000	21,750	62,250
Russian Fed.	330,000	330,000	231,000	24,750	74,250
Turkey	330,000	330,000	231,000	24,750	74,250
Ukraine	270,000	270,000	189,000	37,989	43,011
Total	**1,990,000**	**1,990,000**	**1,393,000**	**169,930**	**427,070**

24. Reserves

Reserves are analyzed as follows:

Presented in EUR (000)	General	Available-for-sale	Total
At 31 December 2010	31,451	(455)	30,996
(Losses) on revaluation of available-for-sale	-	(11,410)	(11,410)
Transferred to income statement due to impairment	-	14,171	14,171
Transferred from retained earnings	6,346	-	6,346
Exchange rate difference due to conversion	200	(200)	0
Foreign exchange adjustments	(338)	338	0
At 31 December 2011	37,659	2,444	40,103
Gains on revaluation of available-for-sale	599	1,469	2,068
Transferred from retained earnings	2,035	-	2,035
At 31 December 2012	**40,293**	**3,913**	**44,206**

The Bank's general reserve is maintained for meeting any unforeseeable risks or contingencies that do not qualify as provisions for impairment and is normally built-up from those released impairment charges during the year.

25. Cash and Cash Equivalents

Cash and cash equivalents are analyzed as follows:

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Cash on hand	2	4
Investments maturing up to 1 month:		
Bank balances	18,225	11,884
Held-to-maturity portfolio	182,500	114,321
Cash and cash equivalents	**200,727**	**126,209**

The commercial papers held in the Bank's portfolio and issued by other financial institutions were rated at a minimum of A1 by Standard and Poor's or P1 by Moody's, in accordance with internal financial policies.

26. Staff Retirement Plan

At normal retirement age (60 years), a staff member is entitled to a pension equal to 1% of his pensionable salary (i.e. average of the two best out of the last five years) multiplied by his/her years of service at the Bank, under the defined benefit scheme. Also upon retirement, a staff member will be entitled to receive in cash the full balance standing to the credit of his/her individual account for the second and third pillars.

Defined Benefit Scheme

The defined benefit scheme covers all eligible employees of the Bank. A qualified actuary performs an actuarial valuation of this scheme at each end of year using the projected unit method, which is rolled forward to the following year accounts. The most recent valuation date was 31 December 2012. The present value of the defined benefit obligation and current service cost was calculated using the projected unit credit method.

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Amounts recognized in the statement of financial position		
Present value of the defined benefit obligations	12,381	7,935
Fair value of plan assets	(9,382)	(7,788)
	2,999	147
Unrecognized actuarial (losses) gains	(2,240)	694
Net liability	759	841
Expenses for the year	985	970
Past service obligation	82	69
Contributions paid	(1,067)	(1,039)
At end of year	**759**	**841**
Amounts recognized in the income statement		
Current service cost	950	826
Interest cost	396	354
Expected return on plan assets	(425)	(374)
Amortization of unrecognized gain	-	-
Past service obligation	64	164
Total included in personnel expenses	**985**	**970**
Principal actuarial assumptions used		
Discount rate	3.85%	5.00%
Expected return on plan assets	3.85%	5.11%
Future salary increase	2.50%	2.50%
Future pension increase	2.00%	2.00%
Average remaining working life of employees	11 years	12 years

The discount rate arises from the yield curves that use data from double A-rated iBoxx bond indices produced by the International Index Company.

The expected return on assets as per provision of the revised IAS 19, has been set equal to the discount rate assumption, i.e. 3.85% pa.

The following table presents the major categories and reconciliation of the plan assets:

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Major categories of plan assets		
Cash instruments	15%	21%
Fixed interest	49%	54%
Equities	29%	19%
Other	7%	6%
Reconciliation of plan assets		
Market value at 1 January	7,788	6,860
Expected return	425	374
Contributions paid	1,067	1,039
Fund benefits	(49)	(137)
Expenses	(97)	(93)
Asset gain (loss)	248	(255)
Fair value of plan assets	**9,382**	**7,788**

The actual investment return on assets of the Fund was 8.2%. The expected return on plan assets has been based on asset structure allowed by the Fund as well as the yield of high quality corporate bonds. The Bank estimates contributions to be paid in 2013 will not materially differ from those paid in the current year.

The funding status at period end and at the end of the last four years was as follows:

Presented in EUR (000)	2012	2011	2010	2009	2008
Defined benefit obligations	12,381	7,935	7,095	5,967	4,431
Plan assets	(9,382)	(7,788)	(6,860)	(5,851)	(4,835)
Plan deficit (surplus)	2,999	147	235	116	(404)
Net experience adjustments on plan liabilities (assets)	**3,183**	**(275)**	**177**	**677**	**(295)**

Defined Contribution Scheme

The pension expense under this scheme was EUR 845 thousand (2011: EUR 487 thousand) and is included in "Personnel expenses."

Greek State Social Insurance Fund

The pension expense of staff that is alternatively entitled to retirement benefits from this fund was EUR 109 thousand (2011: EUR 133 thousand) and is included in "Personnel expenses."

27. Operating Leases

The Bank has entered into lease contracts for its Headquarters and other premises. These are operating leases and include renewal options and periodic escalation clauses. There is no commitment at end of year for non-cancellable lease contracts. Rental expenses for the year included in "Other administrative expenses" totaled EUR 831 thousand (2011: EUR 882 thousand).

28. Related Parties

The Bank has the below related parties.

Key Management Personnel

Key management personnel comprise: the President, Vice Presidents, and Secretary General. They are entitled to a staff compensation package that includes a salary, covered by medical insurance, participate in the Bank's retirement schemes, and are eligible to receive other short term benefits. The amounts paid to key management personnel during the year were EUR 1,189 thousand (2011: EUR 1,200 thousand). Key management personnel do not receive post employment benefits, other long term benefits, termination benefits, nor any share based payments.

The members of the Board of Directors are not personnel of the Bank and do not receive any fixed term salaries nor any staff benefits. The governments of the Member States are not related parties.

Special Funds

Special funds are established in accordance with Article 16 of the Establishing Agreement and are administered under the terms of rules and regulations adopted by the Bank. Special Funds are audited on an annual basis and their assets and fund balances are not included in the Bank's statement of financial position. During 2012, the Bank administered two special funds. Extracts from the audited financial statements are included under the "Summary of special funds."

29. Events After the Reporting Period

There are no other material events after the reporting year that would require disclosure or adjustment to these financial statements.

30. Summary of Special Funds

With the Hellenic Government

The Technical Cooperation Special Fund's objective is to contribute to the economic development of the Black Sea Region's Member Countries. The Fund extends technical assistance grants for preparation of high quality project documentation including business plans, feasibility studies, and financial reporting methods and standards. The movement in the Fund is shown below.

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Statement of movements		
Balance brought forward	345	406
Net income for the year	1	3
Less: disbursements	(55)	(64)
Balance of available funds	**291**	**345**
Financial position		
Placements with other financial institutions	291	345
Total Assets	**291**	**345**
Unallocated fund balance	291	345
Total Liabilities and Contributor Resources	**291**	**345**

With the Development Bank of Austria

The Technical Cooperation Special Fund's objective is to cover reasonable technical cooperation activities in the Bank's member countries, with a strong potential to generate an opportunity for the Development Bank of Austria to co-finance a project in the private sector in connection with a technical cooperation activity. The movement in the Fund is shown below.

Presented in EUR (000)	At 31 December 2012	At 31 December 2011
Statement of movements		
Balance brought forward	332	354
Net income for the year	1	1
Less: disbursements	(15)	(23)
Balance of available funds	**318**	**332**
Financial position		
Placements with other financial institutions	318	332
Total Assets	**318**	**332**
Unallocated fund balance	318	332
Total Liabilities and Contributor Resources	**318**	**332**

Independent Auditor's Report

TO THE BOARD OF DIRECTORS AND GOVERNORS OF THE BLACK SEA TRADE AND DEVELOPMENT BANK

Report on the Financial Statements

We have audited the accompanying financial statements of the Black Sea Trade and Development Bank (the "Bank") which comprise the statement of financial position as at 31 December 2012 and the statements of income and comprehensive income, changes in equity and cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

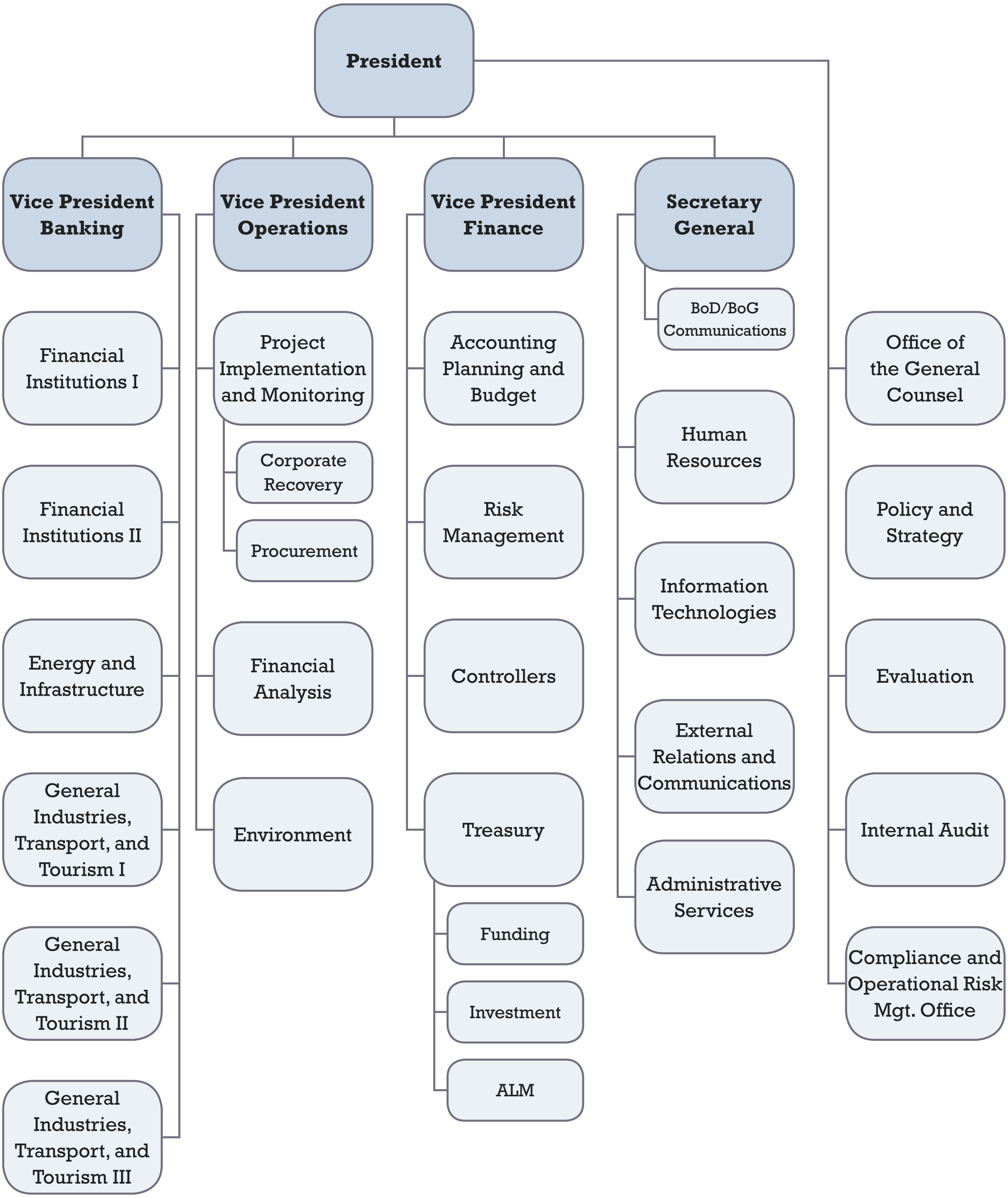
In our opinion, the financial statements give a true and fair view of the financial position of Black Sea Trade and Development Bank as of 31 December 2012 and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

26 April 2013

KPMG Certified Auditors A.E.
Athens, Greece

Annex A

Organizational Chart



As of 31 December 2012

Annex B

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