Black Sea Trade & Development Bank


ANNUAL REPORT 2014

# Contents

# Board of Governors

As of 31 December 2014

| | |
|---|---|
| **Republic of Albania** | |
| Governor: | Mr. Erjon LUCI, Deputy Minister of Finance |
| Alternate Governor: | position vacant |
| **Republic of Armenia** | |
| Governor: | Mr. Arthur JAVADYAN, Chairman, Central Bank of Armenia |
| Alternate Governor: | Mr. Andranik GRIGORYAN, 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 Economy and Industry |
| **Republic of Bulgaria** | |
| Governor: | position vacant |
| Alternate Governor: | Ms. Gergana BEREMSKA, Director, Financial Institutions & Cooperation Directoarate, 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 of Development and Competitiveness |
| Alternate Governor: | Mr. Christos GEROULANOS, Senior Policy Advisor to the Deputy Minister, Ministry of Development and Competitiveness |
| **Republic of Moldova** | |
| Governor: | Mr. Anatol ARAPU, Minister of Finance |
| Alternate Governor: | position vacant |
| **Romania** | |
| Governor: | Mr. Darius-Bogdan VALCOV, Minister of Public Finance |
| Alternate Governor: | Mr. Gyorgy ATTILA, Secretary of State, Ministry of Public Finance |
| **Russian Federation** | |
| Governor: | Mr. Dmitry PANKIN, Deputy Minister of Finance |
| Alternate Governor: | Mr. Sergey BELYAKOV, Deputy Minister of Economic Development |
| **Republic of Turkey** | |
| Governor: | Mr. Cavit DAGDAS, Acting Undersecretary of Treasury, Undersecretariat of Treasury |
| Alternate Governor: | Mr. Burhanettin AKTAS, Deputy Undersecretary of Treasury, Undersecretariat of Treasury |
| **Ukraine** | |
| Governor: | Mr. Aivaras ABROMAVICIUS, Minister of Economic Development & Trade |
| Alternate Governor: | Mr. Sergiy KRUGLYK, Director, Foreign Relations Department, National Bank of Ukraine |

# Board of Directors

As of 31 December 2014

| | |
|---|---|
| **Republic of Albania** | |
| Director: | Ms. Gelardina PRODANI, General Secretary, Ministry of Finance |
| Alternate Director: | position vacant |
| **Republic of Armenia** | |
| Director: | Mr. Vardan ARAMYAN, First Deputy Chief of Staff, Office of the President of the Republic of Armenia |
| Alternate Director: | Mr. Nerses MKRTCHIAN, Director, Multilateral & Bilateral Economic Cooperation Department, Ministry of Foreign Affairs |
| **Republic of Azerbaijan** | |
| Director: | Mr. Famil ISMAYILOV, Deputy Head, International Relations Department, Ministry of Finance |
| Alternate Director: | position vacant |
| **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. Giorgi TABUASHVILI, First Deputy Minister of Finance |
| **Hellenic Republic** | |
| Director: | Mr. Patroklos GEORGIADIS, Secretary General, Ministry of Development and Competitiveness |
| Alternate Director: | Mr. Spyros SPYROPOULOS, Legal Advisor, Office of Mr. Mitarachi, Deputy Minister of Development, Ministry of Development and Competitiveness |
| **Republic of Moldova** | |
| Director: | Ms. Elena MATVEEVA, Head, Public Debt Department, Ministry of Finance |
| Alternate Director: | Ms. Ina GOREA, Deputy Chief, On-Lending Directorate, Public Debt Department, Ministry of Finance |
| **Romania** | |
| Director: | Ms. Diana PELIGRAD BLINDU, Head Operations I, General Directorate for Treasury & Public Debt, |
| Alternate Director: | Mr. Stefan PETRESCU, Head of Operation Division, External Public Finance, Ministry of Public Finance |
| **Russian Federation** | |
| Director: | Mr. Evgeny STANISLAVOV, Director, Economic Cooperation Department, Ministry of Foreign Affairs |
| Alternate Director: | position vacant |
| **Republic of Turkey** | |
| Director: | Mr. Hakan TOKAC, Director General, Foreign Economic Relations, Undersecretariat of Treasury |
| Alternate Director: | Mr. Tahir CANATAN, Deputy Director General, Foreign Economic Relations, Undersecretariat of Treasury |
| **Ukraine** | |
| Director: | Mr. Valeriy PYATNYTSKIY, Commissioner for European Integration |
| Alternate Director: | Mr. Vitaliy LISOVENKO, Deputy Minister of Finance |

# Audit Committee

As of 31 December 2014

**Ms. Milena Boikova**
Director for the Republic of Bulgaria and Chairperson of the Audit Committee;

**Ms. Gelardina Prodani**
Director for the Republic of Albania and Audit Committee member;

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

**Mr. David Lezhava**
Director for Georgia and Audit Committee member

# Management

As of 31 December 2014

**Ihsan Ugur Delikanli**
President / Chairman of the Board of Directors

**Igor Leshukov**
Vice President / Banking

**Valentina Siclovan**
Vice President / Finance

**Nina Stavreva**
Vice President / Operations

**Orsalia Kalantzopoulos**
Secretary General

# 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 2014 as endorsed by the Board of Directors. The Sixteenth 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.

Ihsan Ugur Delikanli
President
Chairman of the Board of Directors

# Statement by the President

For the Black Sea Region, 2014 was the latest chapter in an ongoing cycle of demonstrating resilience and dealing with adversity. Geopolitical turmoil, commodity price shocks, global monetary policy shifts and uncertainty, all impacted economic activity. Nonetheless, the Region pushed forward and real GDP growth, while reduced, was still positive at 1.1%- the fifth consecutive year of post-crisis growth. Countries undertook a range of reforms and once again demonstrated their adaptability, reducing vulnerability to adverse events and placing themselves in position to rebound once external conditions improve.

Operating in this challenging but hardy regional context, we made significant progress in our efforts to fulfill shareholder expectations and achieve targets. Bank activity in 2014 developed at a healthy pace with disbursements increasing to EUR 304.5 million, up from EUR 197.2 million in 2013. The overall active portfolio of operations grew to EUR 962.0 million at end 2014, up 23.4% annually. New operational activity was similarly robust with Board approvals increasing 30.7% to EUR 348.9 million. As a number of these occurred towards the end of the year and are due for signing in 2015, signings ended up decreasing slightly by 5.5%, amounting to EUR 213.0 million for the year. We also maintained our long standing track record of profitability, as income before provisions for 2014 increased 13.7% in relation to 2013, reaching EUR 32.7 million, and net income increased 5.6%, to EUR 14.0 million.

Our Bank's operational achievements were supplemented by key institutional developments in 2014. In February, Moody's Investors Service upgraded the Bank's long-term issuer rating to A2 from A3, and its short-term issuer rating to Prime-1 from Prime-2.

In June, we celebrated the Bank's 15th anniversary at the Annual Meeting in Sofia, and brought together shareholders, other development institutions, observers, partners, and representatives from the Region's business community.

This dialogue contributed to another key development, the preparation of the Bank's Medium Term Strategy and Business Plan (MTSBP) for the period 2015-18. This strategic document enumerates strategic objectives and operational goals the Bank will pursue over the coming four years, in order to fulfill its mandate and enhance the 'value added' of Bank activities. The Bank's Strategy contains a great deal of continuity in terms of the key objectives of the Bank in institutional and operational terms. In addition, it outlines an important strategic shift towards creating a "Communicating and Learning" organization that facilitates information networking, knowledge sharing and dissemination.

In the 15 years of our operations, we have become known to an ever growing number of agencies, banks and firms in the business communities of the Black Sea Region, as a responsive, reliable partner that can help them to realize their aspirations by improving their access to financing, assisting their efforts to expand to new markets, providing risk mitigation services, and helping them to build their network of contacts. We expect to continue building upon this track record, expanding activities and developing innovative solutions that will further foster economic development and regional cooperation.

**Ihsan Ugur Delikanli**
President
Chairman of the Board of Directors

# BSTDB's Key Accomplishments 1999-2014

In June 2014 the Black Sea Trade and Development Bank marked the fifteenth anniversary of the launch of operations. During this period, BSTDB has sought to fulfill its dual mandate to support economic development in member countries and to promote regional cooperation among them by providing financing for investment operations and trade transactions. The Bank has developed a broad range of financial products and services for banks, firms, and agencies in the private and public sector in all its eleven member countries.

- Since the commencement of operations in 1999, BSTDB has approved nearly 300 operations for a total amount of about EUR 3 billion. The Bank has disbursed over EUR 2.6 billion and has supported national economic policy priorities in member countries, focusing on key sectors generating growth and employment in manufacturing, energy, transport, telecommunications, agribusiness, trade, and the financial sector.
- Small- and medium-sized business (SME) is a major source of growth and employment across the region. Under its SME Support Program, BSTDB has provided more than EUR 875 million in SME financing, mainly through local financial institutions in member countries.
- The BSTDB Trade Finance program has supported regional exports and import transactions among member states to the cumulative total amount of EUR 600 million that has been channeled through financial institutions in member countries.
- Regional infrastructure development, including transport and tele-communications, represents a key factor for regional development. The Bank has approved financing to support transport and tele-communications projects exceeding EUR 510 million.
- BSTDB has assisted in a range of energy sector activities, including oil and gas, power supply and distribution, renewable energy and energy efficiency, having approved projects exceeding EUR 475 million.
- The Bank supported municipal initiatives to develop local infrastructure, transport and public utilities, having financed municipal projects exceeding EUR 200 million.
- Maintenance of portfolio quality has remained a key priority. The Bank's operations independently evaluated as positive in terms of efficiency, sustainability and development impact, have grown steadily over the years and reached 75% of the portfolio.
- BSTDB has been consistently profitable since 2004, rolling those profits back into its operational activities in the Region.
- Having obtained an initial investment grade rating from Moody's in 2004, BSTDB has been upgraded three times and currently possesses an "A2" long-term rating. The Bank is also rated "A-" long-term by Standard and Poor's. BSTDB is the highest rated financial institution based in the Black Sea region.
- BSTDB has built networks of cooperation and partnerships with other multilateral and national financial institutions to generate synergies and increase effectiveness of development financing in the Black Sea region. Ten leading development institutions enjoy Observer status with BSTDB: the European Investment Bank, the European Bank for Reconstruction and Development,

the International Finance Corporation, the International Investment Bank, the Nordic Investment Bank, the KfW Banking Group of Germany, the Development Bank of Austria, Proparco of the French Development Agency Group, Vnesheconombank, the Russian development bank, and the Association of European Development Finance Institutions.

BSTDB is a founding member of the International Development Finance Club, a network of 20 leading development finance institutions that cooperate in areas such as corporate governance, evaluation, procurement, legal, institutional transparency, environment and social issues, and human resources.

# Highlights of 2014

In 2014, as a result of business development effort, BSTDB increased the size of the outstanding loan and equity portfolios to EUR 962.0 million, a 23.4 % growth over 2013. The Board of Directors approved 29 new operations for a total of EUR 348.9 million. This represents a 30.7% increase over 2013. Twenty-two new operations were signed for a total of EUR 208 million.

BSTDB posted a net income in 2014, for the tenth consecutive year, which amounted to over EUR 14 million.

The quality of the lending portfolio remained sound, experiencing no additional impaired loan operations.

On February 4, 2014, Moody's Investors Service upgraded the BSTDB's long-term issuer rating to A2 from A3. The short-term issuer rating was also upgraded to Prime-1 from Prime-2. The outlook on the ratings is stable. The upgrade was driven by changes in the assessment of the BSTDB's credit profile, as a result of the adoption of rating methodology for multilateral development banks and other supranational entities.

Standard & Poor's has reaffirmed the Bank's "A-" long term and "A-2" short term ratings with stable outlook in their Research Update issued on October 16, 2014.

On July 16, Mr. Ihsan Ugur Delikanli took up his duties as President of the Black Sea Trade and Development Bank for a period of four years, following the appointment by the Board of Governors.

Mr. Delikanli (Turkey) replaced Mr. Andrey Kondakov (Russia), who has run the Bank since July 2010.

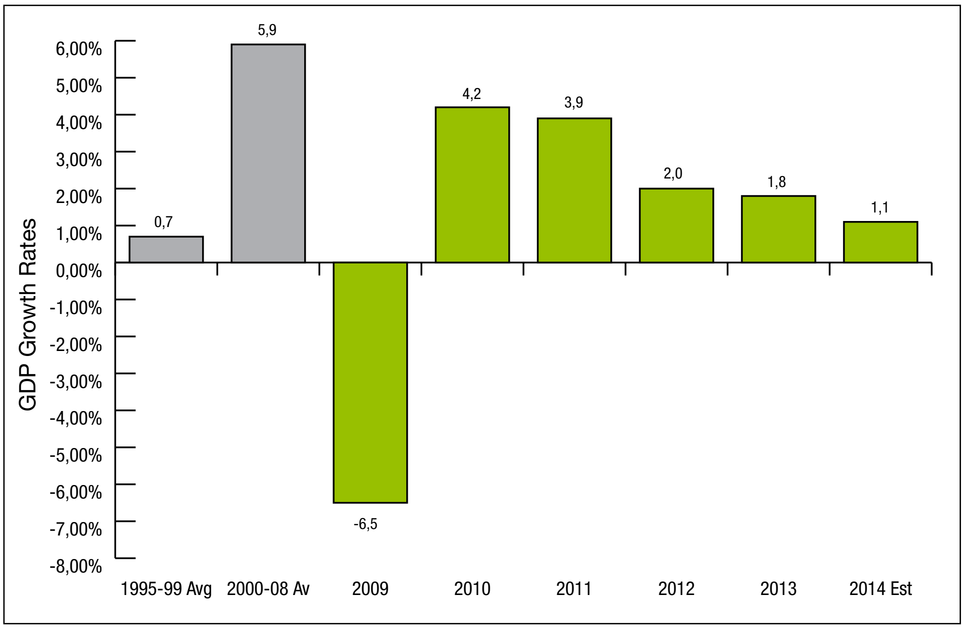
On November 24, Mr. Igor Leshukov entered upon office of BSTDB's Vice President Banking, as appointed by the Board of Directors, for the period of four years. Mr. Leshukov (Russia) replaced Mr. Mustafa Boran (Turkey).

On December 16, Ms. Nina Stavreva assumed duties as Vice President Operations for a four-year period, following the appointment by the BSTDB Board of Directors. Ms. Stavreva (Bulgaria) replaced Mr. Vitalii Mygashko (Ukraine).

# Economic Overview of the Black Sea Region in 2014[1]

The Black Sea Region continued a trend of slowing economic growth in 2014. As Figure 1 shows, average real GDP growth for the Region in 2014 reached 1.1%. For the fifth consecutive year since 2009, when the Region suffered a short but severe recession in the aftermath of the global financial crisis of 2008, the countries comprising the Black Sea Economic Cooperation posted positive growth. Overshadowing this positive result, however, was the fact that for the fifth consecutive year the rate of growth has subsided, and at barely over 1% little progress was achieved in reducing poverty rates, much less in achieving convergence with the wealthy economies of western Europe.

**Figure 1: Black Sea Region Average Annual Real GDP Growth**




Regional per capita incomes declined nine percent in US dollar terms, from USD 11,400 for 2013 to USD 10,400 for 2014; while this figure is primarily a function of the sharp rise in the US dollar in late 2014 and the even sharper depreciations of a number of regional currencies, it was also affected by weak overall growth. Moreover, it represents a return to pre-crisis 2008 levels.

[1] Note on Sources: Unless otherwise specified, Black Sea Region data is based on BSTDB calculations from National Statistical Agencies of the countries of the Black Sea Region and the IMF IFS Database. Additional sources include Global Economic Prospects 2014 of the World Bank (and previous years' GEP editions), and the IMF's World Economic Outlook publications.

For 2014, the Black Sea Region's growth was among the most sluggish globally. As Table 1 shows, the two regions to post weaker growth were: the wealthy countries of the Eurozone area and the emerging market of Latin America and the Caribbean region, while the emerging market of the Middle East and North Africa region was at roughly the same level. The Black Sea Region's growth was less than half the estimated increase in Global GDP of 2.6% in 2014, and for the first time since 2009, and only the third time since 2000, it lagged the average growth rate of the Central European & Baltic Countries ('CEE & Baltics')[2], most of whom joined the EU in 2004 and, as former 'transition' countries, are often compared to the countries of the greater Black Sea Region.

**Table 1: Global GDP Growth for 2014, by Region**

| | World | Black Sea | Euro Area | Eur & C Asia | CEE & Baltics | Eur & C Asia | East Asia | South Asia | Lat Am & Carib | M East & N Africa | Sub-Sah Africa |
|---|---|---|---|---|---|---|---|---|---|---|---|
| 2014 GDP Growth | 2.6% | 1.1% | 0.8% | 2.4% | 2.7% | 2.4% | 6.9% | 5.5% | 0.8% | 1.2% | 4.5% |

Anemic growth in the Black Sea Region brought down that of the Europe and Central Asia region as a whole and was well behind the rates achieved by most other emerging market regions, as developing countries globally grew at a 4.4% clip. This represents a repetition of a pattern of behavior observed over the last few years, as the Black Sea has been among the slowest growing emerging market regions since the global financial crisis. Together with the aforementioned steady decline in growth rates since 2010, these trends portray a worrying regional economic pattern and suggest that significant structural difficulties features may underlie the protracted sluggishness without simple remedies or solutions.

On the 'demand' side, even though trade volumes were down in US dollar terms (due to the strong appreciation of the dollar), exports were a positive contributor, rising nearly three percent. Consumption, normally the single biggest contributor to GDP use at anywhere from 60-80%, grew very modestly. Government consumption rose by approximately 1.3%, roughly in line with the trend of recent years, as most countries have sought to limit spending growth in order to improve fiscal balances and/or reduce debt levels. The much larger component of private consumption grew a meager 0.9%, well below the 4-6% growth levels observed each year between 2010-2013, and certainly affected the overall slowdown in growth. However, investment levels fared even worse, as gross fixed investment declined by around -2.5%, roughly repeating the decline of -2.7% in 2013. Due to fiscal considerations, public investment growth has been limited but has remained positive. Thus, the decline is primarily due to reduced activity of private investors, both domestic and foreign.

Moreover, while the investment figures of the last two years are contractionary, weak investment rates have been characteristic of the Black Sea Region in the aftermath of the 2008 global financial crisis. The higher growth outturns in 2010 and 2011 occurred primarily on the back of a recovery in private consumption and exports. With the exception of Turkey, which enjoyed an investment boom to underpin its post-crisis recovery in those two years, the other large countries of the Black Sea Region have generally posted weak investment growth. Interestingly, the picture has differed among smaller countries, with Albania and the Caucasus countries realizing solid investment levels between 2010-2013, though these too diminished in 2014.

[2] EU members since 2004: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia; since 2013: Croatia.

**Figure 2: Foreign Direct Investment in the Black Sea Region 2000-2014**

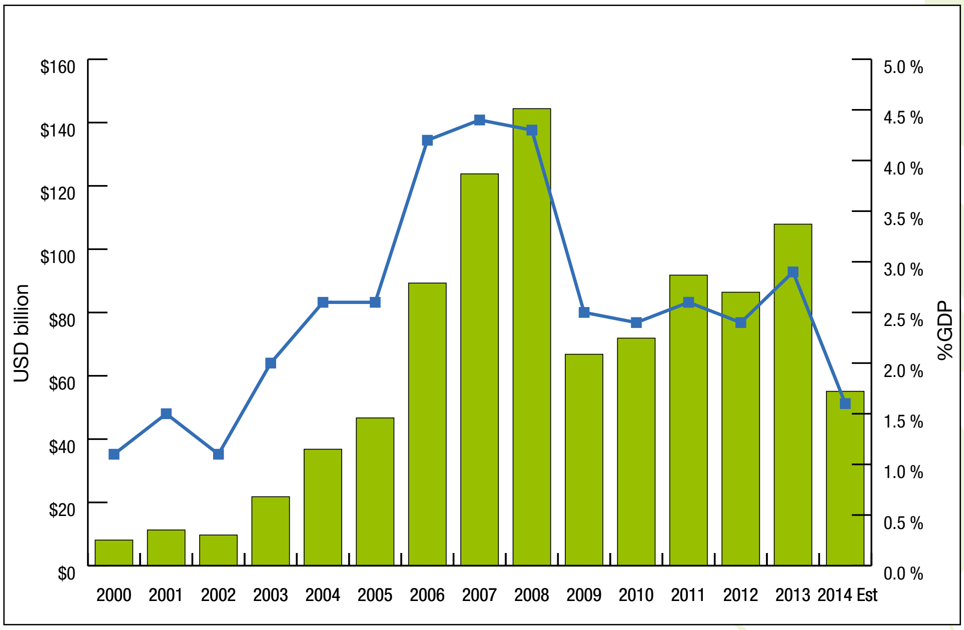



Figure 2 shows how starkly negatively the regional picture has evolved with respect to foreign direct investment (FDI). FDI dipped dramatically in 2009 during the Region's short sharp recession. It recovered during 2010-13, although it did not come close to pre-crisis peak levels, registering between 2.5-3.0% of GDP. In 2014, it once again fell sharply, to around USD 55.1 billion, nearly 49% lower than the USD 107.9 billion that took place in 2013. Even considering the rise in the value of the dollar, the reduction was substantial and this can be seen in its size relative to GDP, as the share of regional FDI/ GDP fell from 2.9% in 2013 to only 1.6% for 2014.

The weak investment flows are problematic not only for their immediate dampening effect on GDP growth, but also for their longer run drag on potential GDP growth in future years. Investment is necessary to expand and modernize infrastructure on the one hand, and to increase the wealth generating capacity of a society on the other hand. Investment that is deferred or foregone thus negatively impacts economic growth in future years as well and results in lower living standards, higher poverty rates, and slower convergence to the income levels of Western Europe.

Turning to the 'supply' side, or origins of GDP, services accounted for around 56% of GDP formation in the Black Sea in 2014. Other than energy producing Azerbaijan, services typically account for 50-60% of GDP formation in Black Sea Region countries, and the figure rises to nearly 70% in countries with significant tourist sectors. Thus, with growth in the services sector slowing to 1.0% in 2014, this was a key driver of the overall slowdown.

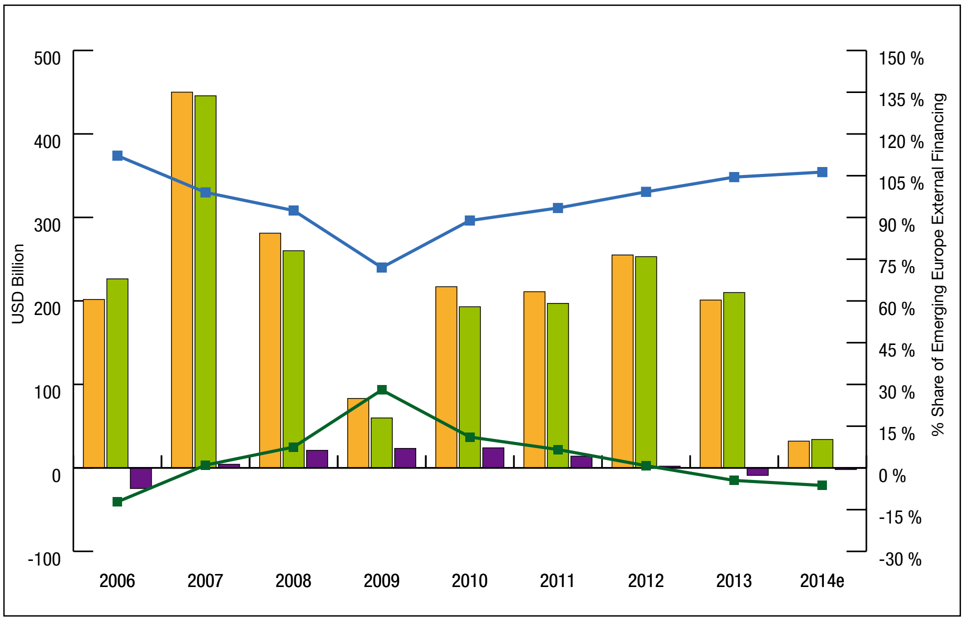
For most Black Sea countries, the share of industry in GDP formation lies between 25-40%, with Azerbaijan the outlier at 60%. In 2014, industry accounted for 32% of GDP formation in the Black Sea Region and experienced growth of around 0.9%, a rate similarly sluggish to that of the services sector. In contrast to services, though, this was the third consecutive year of low growth in the 1% vicinity for industry, and links directly to the aforementioned protracted sluggishness of investment.

Agriculture, the share of which has steadily eroded since the beginning of the last decade from over 10% of GDP to 5.6% in 2014, coincidentally experienced a comparably low 0.7% rate of growth. However, this is in contrast to the experience of previous years in which there was significant volatility in agricultural output change from one year to the next, occasionally reaching double digits (plus and minus) and driven by factors such as changing weather conditions and global commodity price fluctuations. Notwithstanding the year on year fluctuations, the long term trend in GDP formation has been downward, though it has stabilized at between 5-6% since 2010. As a share of employment, agriculture employs a much larger proportion of the working age population across the Black Sea Region, suggesting that it also suffers from lower productivity in relation to other sectors of the economy.

A number of reasons underlie the overall weakness in the Black Sea Region's 2014 economic performance. The key trade and financial partner for most countries in the Region, the European Union and in particular the Eurozone countries, emerged from the recession of 2012-13 caused by the Eurozone crisis, but continued to experience sluggishness and weak demand. GDP in the Euro area, in particular, grew by only 0.8% and underperformed relative to expectations.

The EU also continued unwittingly to 'export' uncertainty, in particular with respect to monetary policy of the European Central Bank (ECB) in the Eurozone as well as the financial sector regulation. With the ECB taking a more prominent role in the supervision of large and systemic financial institutions in the Eurozone, the EU's European Banking Authority undertook stress tests which were published in October 2014. In preparation for those tests, EU banks made concerted efforts to strengthen their capital positions, a significant side effect of which involved reduced cross-border lending activity. The impact was particularly felt in countries in Central and Eastern Europe, including most of the Balkans, where the majority of bank ownership is western European-financial conglomerates based on Eurozone countries. Figure 3 shows how net financial flows into emerging Eastern Europe- including the Black Sea Region- declined sharply in 2014, to USD 32 billion. This represents the worst result since 2001, underperforming even the financial crisis period of late 2008 & 2009, when markets had frozen, and for a while, virtually all lending activity had ceased. Non-resident capital flows to Emerging Europe fell to USD 34 billion, with massive capital outflows taking place in the second half of the year.

**Figure 3: Capital Flows to Black Sea Region and CEE & Baltics**




Source: International Institute of Finance

Beyond the risk aversion created by the uncertainties of Eurozone monetary policy and EU financial regulation, geopolitical tensions in the Region and, to a lesser extent, in the neighboring Middle East also contributed to heightened uncertainty, reduced capital inflows, declining investment and consequently weaker economic performance. The imposition of sanctions on Russia, in particular, triggered sizeable capital outflows by EU based entities who had been the principal foreign lenders for many Russian firms and banks.

The falling prices for key commodities, most notably the halving of the price of oil in the second half of 2014, also introduced a terms of trade shock for the economies of the Black Sea Region. For oil importing countries and countries with large manufacturing sectors, declining energy and commodity prices constituted a positive development, relieving pressure on the current account, reducing input costs and boosting relative competitiveness. These gains mainly apply to countries in the western and southern parts of the Black Sea Region (e.g. the Balkans), and helped to somewhat counteract the impact of the EU's aforementioned negative externalities to which these countries were most exposed.

For commodity exporters, especially energy producing countries, the terms of trade shock were negative and further contributed to weakening economic performance. This holds for Azerbaijan, as well as for the Region's largest economy, Russia. Given Russia's close economic to with a number of states that used to be members of the Soviet Union, many of these states suffered secondary negative shocks from the decline in economic activity in Russia. Thus, even though as energy importers they benefited from lower oil prices, this was offset to a large degree (i) by their exporters experiencing reduced demand for their outputs from the important Russian market, and more importantly (ii) by the fall in the level of remittances from their sizeable émigré populations living and working in Russia- a sizeable effect since remittances account for well over 10% of GDP in certain countries.

Beyond these factors, a structural reason may also have contributed to the slowdown. Like other emerging economies around the world, most of the Black Sea Region entered into a new economic cycle as it emerged from the financial crisis induced economic slowdown of 2009. Despite the lower growth rates in the Black Sea Region, the same pattern of peak growth in 2010 and subsequent gradual slowing with each passing year, has also been observed in East and South Asia, Latin America, and to some extent, Sub -Saharan Africa. Even the Middle East has experienced a similar trend, although conflicts emanating from the Arab Spring led to economic downturns in 2011 and 2013, which distort the pattern in those two years.

In 2014, emerging economies experienced a slowdown and the weakest output growth since 2009, suggesting that several key economies may be coming to the end of the first post-crisis business cycle. Even during the upswing, the Black Sea Region performed less impressively than other emerging regions. But after four consecutive years of growth, much of the Region- particularly in the eastern part- may be coming to the end of a business cycle which, due to the protracted investment weaknesses, was never notably buoyant and remained evermore dependent upon continued increases in consumption or in exports.

The distinction between the eastern and the western part of the Black Sea Region remains important in the post-crisis period, since they continue to exhibit diverging patterns of performance. However, compared to 2010-12, there has been a reversal that began in 2013 and continued in 2014. Whereas between 2010-12 the eastern part of the Black Sea Region broadly performed more strongly, in 2013-14 the trend was largely reversed and it is the western part of the Black Sea that has performed better both in relative and in absolute terms. Albania, Bulgaria and Greece each experienced an increase in real GDP growth in 2014, against the Region's overall declining trend. In the case of Greece, the turnaround was on the order of 4.7% and reversed several years of economic contraction. Romania experienced a slight slowdown, but still posted healthy growth of nearly 3% of GDP. Only Serbia, implementing fiscal austerity under an IMF program, experienced a contraction. In the eastern part, all countries experienced weaker economic performance relative to 2013. Ukraine, facing lingering macroeconomic difficulties along with geopolitical tensions, experienced the largest decline.

Two exceptions to this trend are Turkey and Georgia. Turkey experienced growth around 3%, lower than 2013, but still among the highest rates in the Region and a continuation of a post 2009 unbroken trend of growth, led primarily by private consumption, but with above average export and investment growth as well. Moreover, even though it has experienced a fair amount of volatility, the economy was the best regional performer in terms of attracting foreign capital inflows during 2014. Georgia experienced an increase in real GDP growth in 2014 to around 5%, buoyed by robust domestic demand and, exceptionally for the Region, high rates of investment.

Table 2: Summary of Key Economic Indicators for 2014

| | GDP Growth | Inflation | Cur Acct Bal / GDP | Budget/ GDP | Public Debt/ GDP | FDI/ GDP |
|---|---|---|---|---|---|---|
| Albania | 1.6% | 1.6% | -12.0% | -5.0% | 72.1% | 9.4% |
| Armenia | 3.4% | 3.0% | -7.9% | -2.0% | 45.2% | 3.5% |
| Azerbaijan | 2.8% | 1.4% | 13.9% | 0.5% | 11.2% | 8.3% |
| Bulgaria | 1.7% | -1.4% | 0.0% | -3.7% | 21.2% | 3.6% |
| Georgia | 4.8% | 3.1% | -9.4% | 1.2% | 32.9% | 6.0% |
| Greece | 0.8% | -1.3% | 1.2% | -3.5% | 175.1% | 1.4% |
| Moldova | 4.6% | 5.1% | -5.7% | -1.7% | 30.4% | 2.6% |
| Romania | 2.9% | 1.1% | -0.5% | -1.9% | 40.4% | 1.5% |
| Russia | 0.6% | 7.8% | 3.2% | -1.2% | 8.3% | 1.1% |
| Serbia | -1.8% | 2.9% | -4.5% | -6.7% | 69.9% | 2.7% |
| Turkey | 2.9% | 8.9% | -5.7% | -1.3% | 33.7% | 1.6% |
| Ukraine | -6.3% | 12.1% | -4.1% | -4.4% | 72.7% | 1.6% |
| BSEC Region | 1.1% | 6.8% | 0.4% | -1.6% | 31.7% | 1.6% |

Table 2 summarizes GDP growth and key macro-economic indicators for each BSEC country, and provides a summary for the Region as a whole, based upon weighted averages of the member countries. In addition to the slowdown in overall growth and the decline in FDI already mentioned, the inflation rates rose and current account balance improved. The inflation uptick shows the immediate effects of the devaluation that many regional currencies experienced, versus the Euro and especially versus the US dollar, which appreciated significantly in the second half of 2014. On the whole, inflation picked up, and for the year averaged 6.7%, up from 5.2% in 2013. However, this figure masks considerable variation within the Region, with the eastern part plus Moldova and Turkey experiencing at least some increase in their inflation rates, while the rest of the Balkan countries underwent price level declines, with Bulgaria and Greece slipping into deflation, in the latter case for the second consecutive year. The downward pressure on price levels, and the outright deflation are linked to spillover from the Eurozone, of which Greece is a member and the other Balkan countries are closely linked economically and politically, either as EU members or candidates for EU membership.

The situation with respect to the current account is more mixed. Interestingly, all five largest countries by population in the Region experienced positive changes in their current accounts, while smaller sized countries experienced deterioration. Among the larger sized countries, which tend to be more industrialized and consume more energy, the importers benefited from reduced energy prices. Russia, as a major energy producer, had lower exports, but it also experienced a larger reduction in imports that more than offset the export drop. The currency devaluation in the second half of 2014 likely contributed by reducing demand for imports, but smaller countries also experienced devaluations and their current accounts experienced declines. Rather, the decline in imports in Russia appears to have been primarily a result of policy decisions to restrict imports, especially from the EU. These restrictions took effect immediately, but may have also had aggregate demand reducing effects by creating expectations that more cutbacks are imminent. Whatever the case, small countries with close trade ties to Russia experienced downturns in exports that offset reduced import bills.

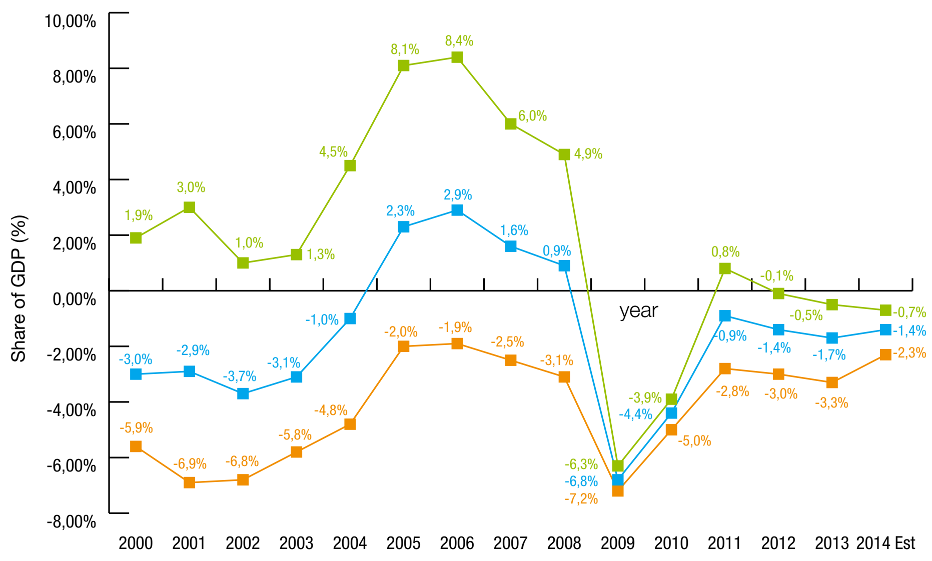
**Figure 4: Trends in Average Fiscal Deficit of Black Sea Region as a Share of GDP**

Share of GDP (%)

Note: Black Sea Region Average - Blue

Russia Alone - Green

Black Sea Region Minus Russia - Orange

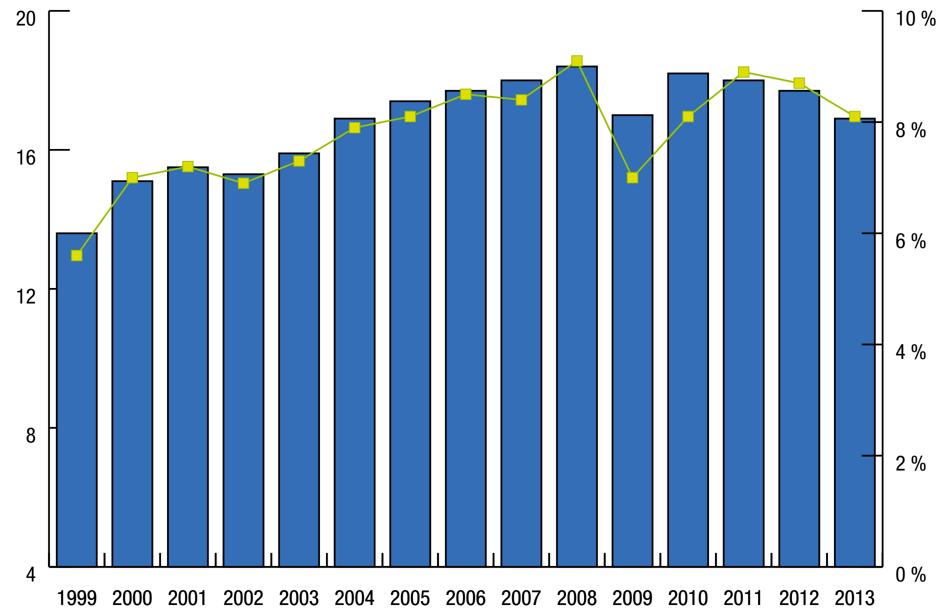



Other indicators, such as fiscal balance and public debt remained relatively stable. Budget deficits in aggregate improved slightly, with the regional average reaching -1.4% of GDP. Fluctuations for the most part were minor, in most cases showing small improvements amounting to less than 1% of GDP. The two outliers were Greece, which saw a substantial correction of nearly 8% of GDP as it sought to achieve a sustainable primary surplus, and Georgia, whose budget balance went from a surplus of around 2.6% of GDP to a deficit of 2.4%, caused mainly by a large increase in public investment to undertake new construction and needed upgrades in existing infrastructure. Public debt levels increased slightly, to nearly 32% of GDP from slightly under 30% in 2013. In most cases, public debt levels are low and very manageable, and concerns lie primarily with the short term nature of debt stocks and the need for external financing sources, which have proven unreliable in recent years. In many countries, external debt is owed primarily to international institutions and official creditors, rather than private investors. This renders such debt more stable and less likely to sudden shifts in investor sentiment. Higher debt countries continued with adjustment programs that included IMF financing.

**Figure 5: Intra-Regional Trade Flows in the Black Sea Region 1999-2013**

Intra-Regional Trade/ Total Trade: Left Axis

Intra-Regional Trade/ GDP: Right Axis




# Regional Cooperation Trends in the Black Sea Region

As a result of the appreciation of the US dollar, the overall external trade of BSEC countries declined by -4.9% by value in 2014, versus 2013. The drop was sharper for imports, which fell -7.1%, than it was for exports, which fell -2.8%. As a share of overall economic activity, however, total external trade rose from 48% of GDP in 2013 to 50% of GDP in 2014. This figure has exhibited variation from year to year, with occasional ups and downs, but its overall trend has been rising over time. The 50% figure for 2014 represents the highest level of trade to economic activity recorded to date and indicates that over time, the importance of international trade has increased for most of the economies of the Region, in some instances significantly so. Put differently the share of external trade to economic activity is one indicator of engagement in the global economy, while the historical trend has been on an upward trajectory.

Individual countries show considerable variation, with Bulgaria, Moldova and Ukraine recording total external trade in excess of 100% of GDP, whereas in countries such as Greece (33%) and Russia (44%), external trade constitutes a much smaller portion of the country's economy. For the other BSEC countries, external trade amounts to at least 50% of overall economic activity, up to around 80%. Albania, Bulgaria, Georgia and Turkey are the four countries which have experienced the largest increase in overall trade to GDP, whereas Azerbaijan and Russia - the Region's two exporters of significant energy resources - have experienced a decrease in the share of trade to GDP between 2000 and 2014, as the rate of growth of domestic consumption and investment has exceeded the increase in external trade.

While overall trade trends are on the rise and suggest that it plays an increasing role in economic activity and prosperity, the situation with respect to trade among BSEC members is more mixed.

Figure 5[3] shows trends in trade within the Black Sea Region among its member countries. Notwithstanding the lags in measurement, there are two clearly discernible trends in the Region. In the period up to the global financial crisis, intra-regional trade grew both rapidly in absolute numbers, and systematically as a share of overall trade and GDP. It peaked at 9.1% of regional GDP and 18.4% of total external trade in 2008. During the recession of 2009 and the freezing up of international markets that followed the crisis, trade levels dropped sharply in 2009 before recovering to a large degree in 2010. However, since 2010 the share of intra-regional trade to overall external trade has been slowly but surely eroding, whereas the share of intra-BSEC trade to GDP picked up in 2010 and 2011, nearly reaching pre-crisis levels, but has since also gone into a gradual but notable slide in 2012 and 2013. These are not long term trends and can certainly change from year to year, but they do suggest that some of the factors underlying the overall economic sluggishness, of which the Region's geopolitical tensions are likely the most important, are having an effect on trade flows and consequently on the degree of regional cooperation. This is further corroborated by the aforementioned declines in FDI flows, in which intra-regional FDI has also suffered.

At a time of frequent international turmoil and persisting perception problems, such underdeveloped commercial and investment ties among Black Sea countries represent significant opportunity costs in the way of lost economic growth, unrealized competitiveness gains, improved efficiency and market access for regional banks and firms. A highly developed regional market can operate as an extended domestic market, in which locally situated banks and firms view the Region as their 'home base' and maintain a more enduring commitment, less prone to volatility from shocks or external misperceptions and biases, since they 'know' their region and are more comfortable working in it.

Successful examples of economic cooperation and close integration exist in other European maritime regions, such as the Baltic Sea and the North Sea. In these cases, government commitment to establish (i) cross-border infrastructure links, (ii) stable and often harmonized policy environments, and (iii) conditions permitting favorable and free movement of persons, goods, services and capital has in turn resulted in a very positive private sector response with significant cross-border flows of financing, trade and investment. With increased political will, the Black Sea Region could similarly move towards taking advantage of the tremendous complementarities that the Region's diversity endows and create an enabling environment for regionally based firms and banks to expand and deepen their activities to the collective benefit of the Region.

[3] Overall export and import estimates for 2014 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 2013 are discussed and shown in the figure.

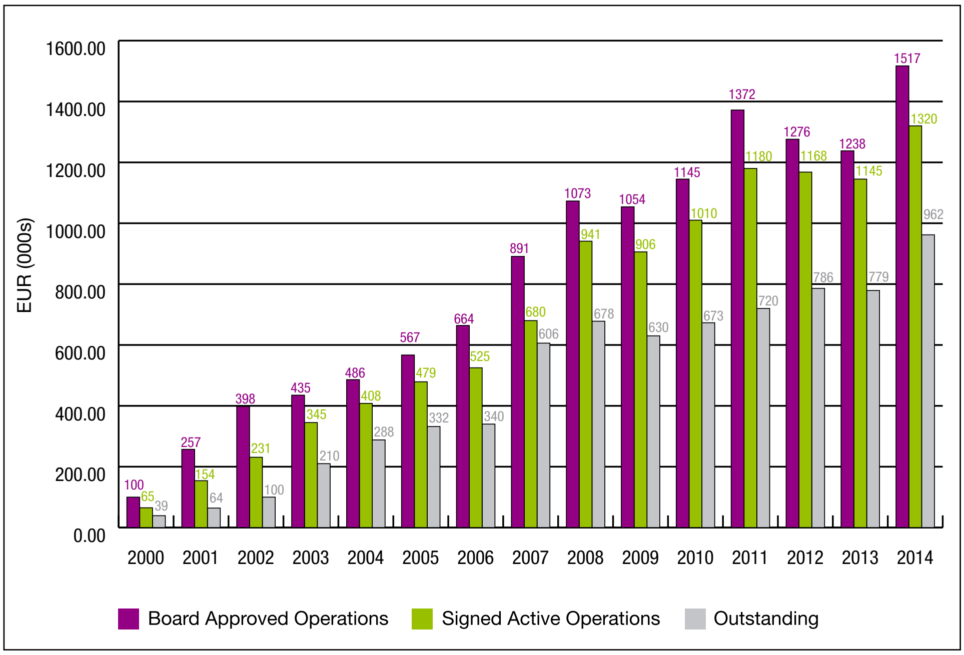
# BSTDB in the Black Sea Region

## Portfolio Description

Since the beginning of operations in June 1999, the Bank has approved 299 operations amounting to about EUR 3.5 billion. Throughout this period, there were 256 signed operations for a total amount of EUR 2.8 billion. A total of 206 operations for about EUR 2.2 billion were repaid. At end-2014, there were 109 operations in the active[4] outstanding portfolio for EUR 962.0 million. At end-2014, the Bank had only four problem loans, representing 5.0% of the value of the total outstanding portfolio.

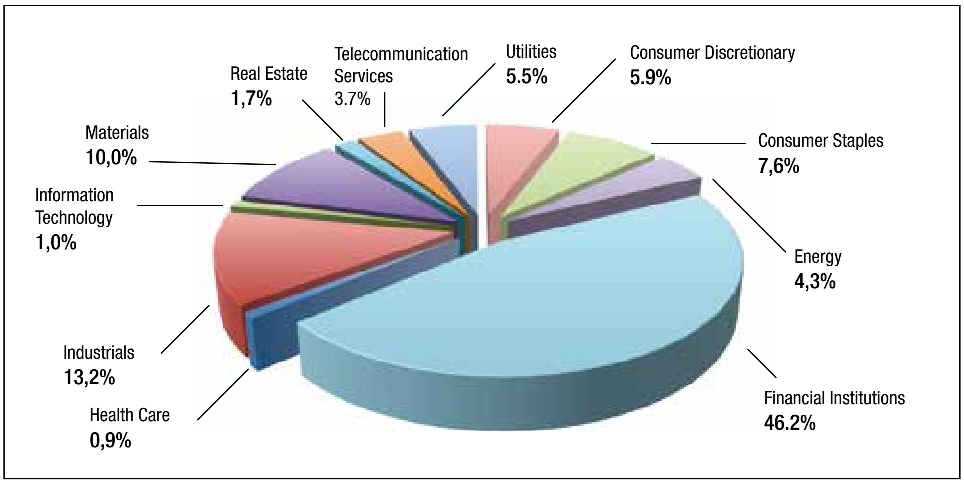
**BSTDB Portfolio Development 2000 - 2014**

Source: BSTDB




**Cumulative Signed Operations by Sector**

Source: BSTDB

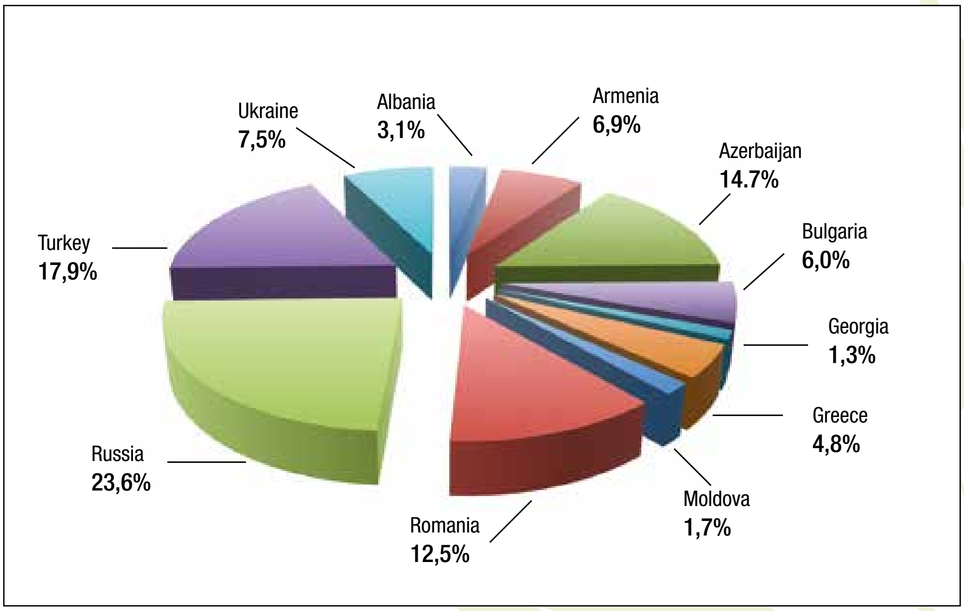



[4] The active operations in the Bank's portfolio are those currently in any of the phases from Board approval to full repayment (approved, signed, disbursed and in repayment).

As of end-2014 the outstanding operations of the Bank (cumulative disbursements less repayments for active operations) represented EUR 962.0 million, distributed by country as per the following graph:

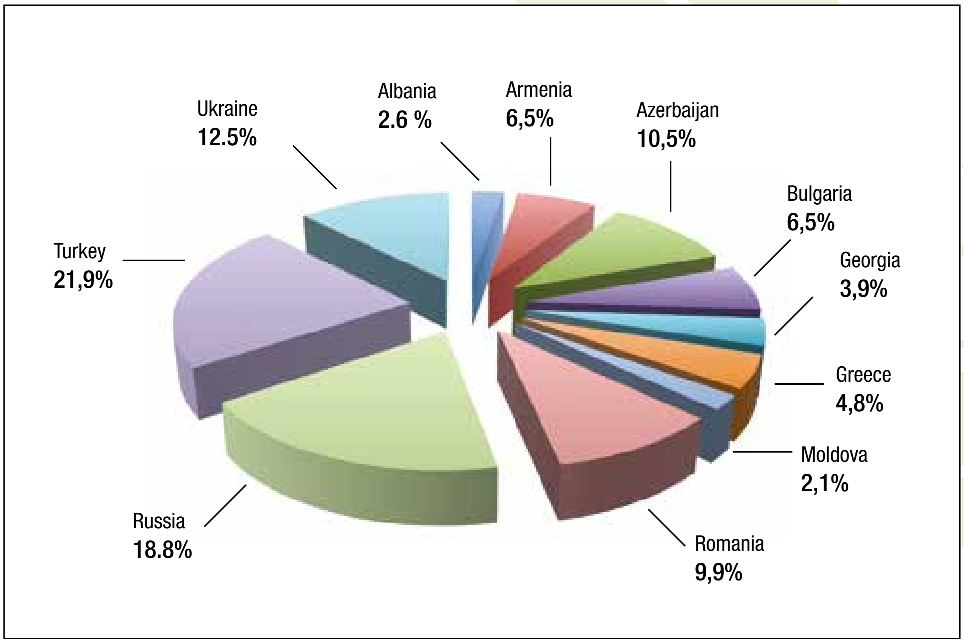
**Outstanding Operations by Country**

Source: BSTDB




**Active Signed Operations by Country**

Source: BSTDB



## 2014 Portfolio Developments

In 2014, as a result of business development efforts, the Board of Directors approved 29 new operations for a total of EUR 348.9 million. This represents a 30.7% increase over 2013. Twenty-two new operations were signed for a total of EUR 208 million, a decrease of 5.5% compared to 2013.

As a result, the Bank had 109 outstanding operations to 90 borrowers at the end of 2014.

Portfolio structure by sector remained broadly in line with the Bank's historical trends. As in previous years, the most significant exposures were in financial institutions, industrials, consumer staples, materials and utilities, which accounted for over 90% of the outstanding portfolio. The Bank maintained a strategic focus on the SME sector development, trade finance, leasing and mortgage lines of credit extended through financial intermediaries in member countries.

## 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 share-holder value for the Bank and are therefore priority activities.

In the course of 2014, 10.8% of signed portfolio was co-financing. In terms of total signed active portfolio in the amount of EUR 1.3 billion, 33.8% of operations are co-financing. The share of co-financed active operations to total active outstanding portfolio is 38.9%.

In 2014 the Bank co-financed the following operations:

1. EDPR Romania PV with EUR 10.0 million for a total amount of EUR 67.4 million with EBRD and equity holders.
2. Teamnet International S.A. with EUR 12.5 million for a total amount of EUR 34.6 million with IFC.

## Technical Cooperation Special Funds

The Bank administers a Special Fund (the "Hellenic Fund") established in July 2001 by a Contribution Agreement between the Government of the Hellenic Republic and BSTDB. The Fund was set up with an initial amount of EUR 800,000 and was replenished in 2003 with the amount of EUR 500,000. This is the Bank's first Special Fund and it responds to a need expressed by the Bank for higher quality of the information provided by the Bank's prospective clients. 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 other member countries of the Bank. Since its inception, the Hellenic Fund disbursed around EUR 1.2 million for 35 consulting assignments. The companies benefitting from these funds operate in manufacturing, telecommunications, oil and gas, transportation, agribusiness, renewable energy, tourism, real estate, retail and banking. The Hellenic Fund has been used for consultancy services in nine BSTDB member countries: Albania, Armenia, Bulgaria, Georgia, Greece, Moldova, Romania, Russia and Ukraine. In 2014, the Hellenic Fund financed four new assignments related to the commercial, market and financial due diligence of potential projects for the Bank in Greece and Armenia. The total amount of the Hellenic Fund used in 2014 was EUR 140,536.

Also, the Bank administers a Technical Cooperation Special Fund (the "Fund"), established in Oct. 2008 with the Development Bank of Austria (the "OeEB"). The OeEB contributed to the Fund an initial amount of EUR 500,000 provided by the Government of Austria as Official Development Assistance (ODA). 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 in the eligible countries of the Black Sea region. The Fund represents the first financial facility of this kind, provided to BSTDB by an institution not based in the BSTDB countries of operation. It can be used for assignments in the BSTDB member countries that are eligible to receive ODA.

In 2014, the Fund co-financed a planning and budgeting project and the introduction of a savings product for a commercial bank, which is a BSTDB client in Azerbaijan. The purpose of the assignment was to improve sales planning and client services. The total cost of the assignments was paid 50% by the Fund and 50% by the beneficiary of the assignment.

The Fund also co-financed four due diligence assignments for the appraisal of an agro-poultry project in Azerbaijan and three due diligence assignments for the appraisal of a furniture manufacturer in Azerbaijan. The assignments involved technical assistance for market analysis, environment impact assessment, preparation and audit of IFRS financial statements etc. The cost of the assignments was financed 50% by the Fund and 50% by the appraised companies. The technical assistance provided was instrumental for completing the due diligence by the Bank. Subsequently, the provision of long term loans to the two companies was approved by BSTDB.

Since its establishment, the Fund has disbursed EUR 263,000, mainly for project preparation assignments.

# Selected BSTDB Financings in 2014

## Kastamonu Integrated Wood Industry (Romania and Bulgaria)

BSTDB provided a long-term corporate loan of EUR 31.5 million to finance Kastamonu Group's expansion project and associated working capital needs in Romania and Bulgaria.

The Bank funding is expected to bring positive impact by supporting provision of quality products in the Black Sea region's markets, at prices affordable for furniture manufacturers and construction businesses. It will contribute to creating additional employment and will promote cooperation among the BSTDB member states, as the sponsor is a Turkish entity investing in Romania, Bulgaria and Russia. Kastamonu Group's products are sold in almost all BSTDB member countries.

| | |
|---|---|
| BSTDB amount: | EUR 31.5 million |
| Type of financing: | corporate loan |
| Maturity: | 7 years |

Kastamonu Romania

Kastamonu Bulgaria

## P. Pavlides (Greece)

The EUR 7 million long-term corporate loan provided to P. Pavlides S.A. is aimed at supporting the company's capital expenditure program of EUR 4.9 million and at providing it with a working capital of Euro 2.1 million. P. Pavlides is an export-oriented Greek company specialized in production of canned fruits.

The funding will be used to finance capital maintenance and upgrade of the company's production facilities, aiming at improving the energy efficiency of the production processes and, thus, contributing to cost reduction. The loan will also be used to provide the company with a long-term working capital that is essential for canned peach production, because of its seasonality.

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| BSTDB amount: | EUR 7 million |
| Type of financing: | corporate loan |
| Maturity: | 7 years |

## Embawood (Azerbaijan)

Embawood LLC is the largest furniture manufacturer in Azerbaijan and is a significant employer in the non-oil sector in the country. The company has been investing along the years to improve its competiveness. The USD 14 million corporate loan provided by the Bank is aimed at supporting this continuous investment effort and will be used for capital investments in several production units of Embawood Group, as well as for working capital. The investments financed with Bank funding include the expansion of Massali mattresses production unit and co-financing a greenfield project of Embawood Group, which plans to diversify its activities by starting to produce concrete pavements.

The loan will support the further development of a very dynamic private company, active in the non-oil sector in the country. It is expected to have positive economic benefits for the Azerbaijani economy, due to new jobs creation and tax revenue gains.

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| BSTDB amount: | USD 14 million |
| Type of financing: | corporate loan |
| Maturity: | 6 years |


## TeamNet International (Romania)

The BSTDB provided a long term loan of EUR 7.5 million and equity of EUR 5 million to TeamNet International (TNI), one of the top three IT&C (Information Technology & Communications) in Romania. The funding will finance TNI's capital investment and working capital needs required for the existing operations in Romania and Moldova, the rollout of new operation centers in Turkey and possibly other countries in Eastern Europe, as well as upgrading TNI's software platform and products. With 13 years of experience, TNI is one of the most important IT&C integrators in Romania, with a complex portfolio that includes system integration solutions, consulting and outsourcing services. TNI recorded a turnover of EUR 71 million in 2013 and has been included for the sixth year in a row in Deloitte Technology Fast 50 Central Europe. Moreover, TNI is the only Romanian company included in the „Big 5" category of Deloitte Technology Fast 50 Central Europe in 2013, ranking third. IFC also co-financed the project with an equivalent EUR 7.5 million debt facility and EUR 5 million equity.


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| BSTDB amount: | EUR 12.5 million |
| Type of financing: | corporate loan and equity |
| Maturity: | 7 years (for the loan) |

## EDPR Romania PV (Romania)

BSTDB provided long term debt facilities of EUR 10 million to six special purpose companies (SPVs) incorporated under the Romanian law and controlled by EDP Renovaveis S.A. (EDPR). The loans have been used for the construction, operation and refinancing of costs (financed by EDPR equity) of a solar photovoltaic park. EDPR is a leading global renewable energy company, majority owned by EDP (Energias de Portugal), a vertically integrated utility. The six SPVs own a 50.4 MW solar photovoltaic (PV) park in southern Romania, close to the Serbian and Bulgarian borders, in Mehedinti, Dolj and Olt counties. Solar photovoltaic technology, one of the fastest-growing power-generation technologies in the world, is used for electricity generation in more than 100 countries. Current solar capacity in Romania is 1,158 MW, providing electricity to over one hundred thousand homes. The project consists of six solar plants, which will contribute to the expansion of renewable energy market in Romania and will support the country in achieving its target of sourcing 38% of its electricity consumption from renewable sources by 2020. It generates carbon-free electricity, uses local labour and has mobilized funding from outside Romania. The EBRD also co-financed the project with EUR 20 million debt facility.

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| BSTDB amount: | EUR 10 million |
| Type of financing: | project finance loan |
| Maturity: | 14 ¼ years |

## Ameriabank (Armenia)

In July 2014 BSTDB signed with Ameriabank (Armenia) a USD 10 million medium-term loan for financing small and medium sized enterprises (SMEs). The facility contributes to expanding the SME lending program of Ameriabank and facilitates the access to medium term finance for small and medium sized private businesses and entrepreneurs.

The operation supports the development of the real economy sector, which is one of the BSTDB priorities. The loan is expected to help raise the competitiveness of SMEs, while also providing a boost to the banking sector in Armenia. Along with these, BSTDB will promote job creation, income generation, and increase the trade turnover of Armenia with other BSEC countries.

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|---|---|
| BSTDB amount: | USD 10 million |
| Type of financing: | SME financing |
| Maturity: | 6 years |

SMEs financed with BSTDB loan

SMEs financed with BSTDB loan

## Terna Energy II (Greece)

A long-term corporate loan of EUR 8.5 million was extended to Terna Energy S.A. (Greece) for the implementation of the company's investment program, involving the construction and operation of 8 biogas power plants in Greece.

The loan will support the further growth of one of the largest private companies in Greece. The Bank financing will contribute to creating new jobs, both temporary during the implementation of the investment program and permanent, once the biogas plants are operational.

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| BSTDB amount: | EUR 8.5 million |
| Type of financing: | corporate loan |
| Maturity: | 6 ½ years |

## SAS II (Armenia)

A long-term corporate loan of USD 10.145 million with a tenor of 7 years was provided by the Bank to SAS Group (Armenia), to finance the development program of the company, involving the construction of a new store in Yerevan, bakeries at the existing retail outlets and an expansion of the company's on-line supermarket.

The Bank will support the development of one of the largest retail trade operators in Yerevan. The operation will result in establishing new jobs and in increasing tax revenues for the Armenian budget.

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| BSTDB amount: | USD 10.145 million |
| Type of financing: | corporate loan |
| Maturity: | 7 years |

## FONDI BESA (Albania)

BSTDB provided a EUR 6 million loan facility to support the activities of FONDI BESA in financing micro, small and medium-sized enterprises in Albania. Through this financing, as FONDI BESA has about 29,000 active clients and 67 offices all around the country, BSTDB is able to reach a larger number of micro, small and medium-sized businesses in Albania and contribute to the development of the small and medium-sized companies in the country. Along with the institutional development of FONDI BESA, resulting in further business growth, improved liquidity and client service, BSTDB is promoting job creation, income generation, improved companies infrastructure, and has positively impacted on poverty alleviation.

The operation is expected to have positive economic impact on the Albanian economy, the most relevant being additional tax revenues from increased economic activity. Also, the funding will contribute to further benefits such as employment creation and enhanced competitiveness. Strengthening the non-bank financial sector is also favorable for the Albanian economy.

SMEs financed with BSTDB loan

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|---|---|
| BSTDB amount: | EUR 6 million |
| Type of financing: | SME financing |
| Maturity: | 3 years |

## Garanti Leasing (Romania)

BSTDB's EUR 7.5 million loan to Garanti Leasing Romania (owned by Türkiye Garanti Bankasi A.S., one of the largest private banks in Turkey) is targeted to support SMEs by financing their capital goods leases. The proceeds of the facility will be used exclusively for funding new and for re-financing existing lease transactions that satisfy lease transaction eligibility criteria.

The transaction is expected to have favorable economic benefits for the Romanian economy, the most relevant being additional tax revenue from increased economic activity. Moreover, the transaction will enhance benefits such as employment creation, increase in export capacity and competitiveness and multiplier effects for other sectors of the Romanian economy. The transaction will not only support Garanti Leasing's activities and diversify its funding sources, but will also contribute to the regional cooperation between Romania and Turkey. Enhancing the cooperation among its member countries is one of the key BSTDB objectives as a regional development bank.

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| BSTDB amount: | EUR 7.5 million |
| Type of financing: | SME leasing |
| Maturity: | 5 years |

SMEs financed with BSTDB loan

SMEs financed with BSTDB loan

## AccessBank (Azerbaijan)

A USD 15 million loan for small and medium-sized enterprises (SMEs) was extended to AccessBank (Azerbaijan). The loan facility is designed to provide funding to a large number of small businesses that otherwise could not be reached by BSTDB, by direct lending.

The loan is aimed to support the development in the non-oil sector in the country and is expected to have favorable economic impact on the Azerbaijani economy, from enhanced economic activity and multiplier effects on other sectors. Furthermore, it will contribute to an increase in employment and competitiveness.

Other BSTDB countries are important trade partners for Azerbaijan, therefore, the facility is expected to contribute to the regional cooperation, to the extent that eligible SMEs engaged in trading with other BSTDB member countries are financed under this facility.

SMEs financed with BSTDB loan

| | |
|---|---|
| BSTDB amount: | USD 15 million |
| Type of financing: | SME financing |
| Maturity: | 3 years |

## Ekspo Faktoring (Turkey)

BSTDB increased the revolving short-term trade finance loan to Ekspo Factoring to a total of USD 10 million. The company had successfully utilized the first USD 5 million credit line provided by the Bank in 2013 and this is the first increase of the initial facility, following its successful implementation. Under the facility, the cumulative Bank disbursements to the company reached USD 11.4 million by the end of 2014. The loan aims to assist Ekspo Faktoring in extending export/import financing to its customers in Turkey that import goods from BSTDB member countries or export to any country.

BSTDB's continued cooperation with Ekspo Faktoring demonstrates the Bank's support to the non-banking financial sector in Turkey. The transactions financed with Bank funding will have positive impact on regional cooperation, helping to enhance the intra-regional trade, as other BSTDB member countries are important trade partners of Turkey.

| | |
|---|---|
| BSTDB amount: | USD 10 million |
| Type of financing: | trade finance |
| Maturity: | up to 370 days, revolving |

SMEs financed with BSTDB loan

SMEs financed with BSTDB loan

## Fabrica de Lapte Brasov - Corporate Loan II (Romania)

A long-term corporate loan of EUR 10 million was provided to finance the investments and associated working capital needs of the dairy production plant of Fabrica de Lapte Brasov (Romania), controlled by TYRAS Group (Greece). The capital investments include: the installation of a milk receiving and pasteurization line, construction of a storage area for packaging materials, purchase of equipment for cooling milk and cleaning production lines, establishment of a new fire-safe system for electronics and improvements in the waste-treatment facility.

The funding extended by the Bank is expected to bring a positive impact by generating additional export and tax revenues, supporting the activities of a successful private company active in Romania and Greece and promoting the cooperation among BSTDB member states via investments and exports.

| | |
|---|---|
| BSTDB amount: | EUR 10 million |
| Type of financing: | corporate loan |
| Maturity: | 5 years |

# Fulfilling the Sustainability Mandate

## Background

Since 1999, when BSTDB started its activity, the sustainability of its operations was one of the key principles the shareholders embedded into the core of the Bank's business model. Thus, the Board of Governors in April 1999 adopted through resolution No.7 the Rules and Regulations for Financing Projects and Commercial Activities of the Bank that regarded promotion of sustainable development of its Member States as the main objective of BSTDB. The Bank adhered at that time to the principles of the Washington Declaration on Environment and Sustainable Development of the World Federation of Development Financing Institutions and committed to support only operations that meet the sustainability principles.

These principles were successfully translated into the BSTDB's first Environmental Policy, which was approved by its Board of Directors in June 1999. The Policy defined the environmental mission of the Bank, which was to integrate environmental concerns into the internal assessment procedures of the financed operations, and the Bank committed to make sure that its activities do not harm the environment; instead they strengthen the environmental management of its Clients; and help address global environmental concerns.

Over the years the Bank has built a solid environmental management system that is fully integrated into its operations cycle, internal procedures and practices and which was constantly updated and enhanced so that BSTDB could achieve its objective effectively and in an efficient manner.

2014 was just another milestone year for BSTDB in which another important step was made in promoting sustainability in its Member States. It is the year in which the new BSTDB Environmental and Social Policy, approved by its Board of Directors in September 2013, was put into effect, and which came to support even further the Bank's efforts in fulfilling its sustainable development objective. The new Policy considers the social dimension of sustainability along with the environmental one in a more inclusive and structured manner and is designed to integrate the sustainable development principles even deeper into its business management. These relate primarily to pollution prevention and mitigation, respect for fundamental human rights in the working environment, protection of the Black Sea against pollution, addressing climate change, promoting sustainable use of natural resources, protection and conservation of biodiversity and disclosure of information on environmental and social performance of its operations.

## The 2014 Environmental and Social Policy

### Commitments

BSTDB recognizes that its financing activities may generate temporary and longer term impacts on the state of the environment and well-being of the people in its Members States, which can be both positive and negative. Therefore, the Bank commits to undertake the necessary measures to prevent and mitigate these risks and negative impacts to the extent feasible on one hand, and maximize the positive effects on the other.

BSTDB understands that in order to manage environmental and social risks and impacts associated with its operations efficiently, these need to be thoroughly identified, assessed, mitigated and monitored. In this respect, the Bank commits to undertake environmental and social assessment and monitoring of all its operations commensurable to their potential risks and impacts and to ensure that these are structured and implemented in accordance with the requirements of its new Policy.

BSTDB considers that environmental pollution should be rectified at source rather than mitigated at the "end of pipe" and that measures to prevent pollution should be regarded by its Clients as a priority, and as early in the planning process of any new development as possible. Any historic or existing environmental pollution that has occurred or is unavoidable should be identified, made as minimal as possible, handled in an appropriate way and in accordance with BSTDB requirements, and if necessary compensated to any affected parties. In this respect, the Bank commits to ask its Clients to prevent pollution at source where possible, and apply the principles of pollution prevention and polluter pays to all its financing operations.

BSTDB regards the respect for fundamental human rights in a working environment as a crucial element of sustainable development. The right for decent work, observance of minimum age of employment, fair and equal treatment and opportunity, respect for health and safety, freedom of association and recognition of the right to collective bargaining are all good practices as defined by the International Labor Organization (ILO) Core Labor Standards (CLS). In every operation it finances, the Bank will seek to ensure, as a minimum requirement, that these rights be required to be upheld and respected by its Clients in the agreements governing the Bank's financing.

Furthermore, BSTDB is committed to the ILO conventions against forced labor and child labor and supports the fundamental human rights for decent work and social justice, as well as the rights of children to develop physically and mentally to their full potential. The Bank commits to be mindful of these issues throughout its operations and to not knowingly engage in financing any activities that may be suspected of involving forced labor and/or child labor, including the supply chain to the extent feasible.

BSTDB recognizes the role and importance of the Black Sea in the sustainable development of the region, the economic, social, and health values of its marine environment, as well as the high vulnerability of its ecosystems due to the special hydrological and ecological characteristics. Therefore, the Bank commits to take full account of the protected status of the Black Sea, as defined by the International Convention on the Protection of the Black Sea against Pollution and relevant International Maritime Organization (IMO) conventions, where appropriate in its operations. The Bank will also seek to ensure that its operations both marine- and land-based, which have the potential to add to the existing pollution and eutrophication, employ efficient preventive and mitigation measures and focus on improving the status of its biodiversity and marine safety.

BSTDB regards climate change as a serious challenge that is not bound by political or geographical borders, and affects the state of the environment and well-being of people globally. The Bank commits, therefore, to contribute to addressing this issue at a regional level by including as part of its lending portfolio the financing of appropriate operations in its Member States that reduce Green House Gas (GHG) emissions, apply energy efficiency measures, cleaner production, use of renewable energy sources, and meet carbon emissions targets set by the Governments or proactively by Clients.

BSTDB recognizes the importance of biodiversity conservation and the vital services the ecosystems provide to humans and businesses, such as food, fresh water, clean air, raw materials, water purification, carbon storage and sequestration, protection from natural hazards, climate regulation, natural areas for recreation and aesthetic enjoyment, soil formation, nutrient recycling, primary production, etc. Therefore, the Bank commits to promote through its operations sustainable use of living natural resources and protection and conservation of biodiversity.

BSTDB considers transparency and accountability as key elements of a sustainable business development. The Bank commits to disclose to the general public information on environmental and social performance of its operations, as per the provisions of this Policy, and require its Clients to engage in dialogue with their stakeholders, identify and interact with potentially affected communities, disclose relevant information about their business activities, consult them as appropriate, and ensure their informed participation. Furthermore, BSTDB provides a grievance mechanism to manage concerns raised by the stakeholders potentially affected by its operations.

## Environmental and Social Assessment

All operations financed by BSTDB are subject to environmental and social assessment, thus allowing the Bank to take an informed decision on whether to provide financing to the assessed prospective operation, and if so, what are the environmental and social issues that need to be addressed during planning, financing and implementation of the operation.

The environmental and social assessment of operations financed directly by BSTDB, focuses on the following issues depending on their relevance to each particular case: the environmental and social management arrangements of the Client; labor and working conditions and how people are treated in the working environment; the applied pollution prevention and abatement measures and how efficiently the resources are being used; potential risks on the local communities, their health, safety and security; issues related to land acquisition, involuntary resettlement and economic displacement; impacts on biodiversity, ecosystem services and sustainable use of living natural resources; protection of any cultural heritage and potential risks and impacts on Indigenous Peoples.

The environmental and social assessment of operations financed by BSTDB through Financial Intermediaries (FIs) focuses on the capability of such FIs to manage environmental and social risks and impacts associated with their business activity, in a manner that is compliant with the requirements of its Environmental and Social Policy and the national legislation in effect in the country of operation, including the country's commitments under international law. If these are found to be satisfactory the Bank would normally delegate the function and responsibility for environmental and social assessment to its Client FIs.

BSTDB categorizes its operations into A, B+, B, C and FI categories, based on 1) the associated potential environmental and social risks and impacts, and 2) the scope of environmental and social assessment necessary to identify, assess and mitigate these impacts and risks.

Category A operations are subject to Environmental and Social Impact Assessment (ESIA) process and require meaningful consultation with the public that may be affected by such operations. This includes setting of procedures for public notification, disclosure of related information about the operation and its potential environmental and social risks and impacts, public review and comment.

The environmental and social issues identified during the environmental and social assessment process of any operation need to be addressed by the Client throughout the life of the BSTDB financing by implementing relevant preventive and mitigation actions. These actions are normally set forth in form of an Environmental and Social Action Plan (ESAP) and its implementation is part of the operations' financing terms and conditions.

## Environmental and Social Standards

BSTDB seeks to apply good international environmental and social practices in all the operations it finances. By good practices, the Bank recognizes the following: the World Bank (WB)/ International Finance Corporation (IFC) Performance Standards, and Environmental, Health and Safety (EHS) Guidelines; the European Bank for Reconstruction and Development (EBRD) Performance Requirements; the European Principles on the Environment (EPE); the European

Investment Bank (EIB) Environmental and Social Practices Handbook; the European Union (EU) environmental and social standards; the ILO CLS; the World Health Organization (WHO) standards; relevant IMO conventions as well as relevant international conventions, such as but not limited to the Convention on the Protection of the Black Sea Against Pollution; also, the multilateral environmental agreements under the United Nations Economic Commission for Europe (UNECE), in particular the Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters (Aarhus Convention), and Convention on Environmental Impact Assessment in a Trans-boundary Context (Espoo Convention).

In co-financed operations the Bank accepts for reasons of consistency and to avoid duplication, the environmental and social requirements of its partners if these are equivalent or superior, more developed or more stringent than its own requirements in this respect.

## Environmental and Social Compliance Requirements

All operations financed by BSTDB comply at minimum with the following environmental and social requirements:

- National and applicable EU environmental, labor, health and safety, and public information laws and regulations, including national commitments under international law;
- Availability of permits, approvals, licenses and certificates required under relevant laws and regulations;
- Category A operations need to meet the requirements applied by EU, namely the Environmental Impact Assessment (EIA) Directive and relevant sector-specific and cross-cutting Directives, or the requirements applied by WB/IFC. Category A operations that are likely to generate trans-boundary impacts need to meet the requirements stipulated under the Espoo and Aarhus Conventions irrespective of whether the country of operation is a party to the Convention;
- Meet the requirements of the BSTDB Environmental and Social Exclusion List.

The Bank commits that its operations are covenanted by its Clients to be compliant with these requirements. In addition to that, the Bank translates into covenants the findings of the environmental and social assessment carried out for its operations. These may include implementation of ESAP, Environmental and Social Monitoring Plans, Consultation and Resettlement Plans, etc. These terms and conditions are tailored to reflect the nature and scope of each particular operation financed by BSTDB.

## Public Information and Disclosure

BSTDB undertakes to inform the public in a transparent and timely manner about the environmental and social aspects associated with its operations. This information is posted on the Bank's website as Operation Summary Documents (OSDs) and includes general information about the operation financed, as well as information on environmental and social categorization, the potential risks and impacts, and how these will be addressed throughout the life of the BSTDB financing. OSDs are disclosed to the public after such operations are approved by the Bank's Board of Directors.

BSTDB also discloses to the general and/or interested public relevant environmental and social information of its Category A operations. For private sector operations this information is disclosed no later than thirty (30) calendar days before the Board of Directors, approval, and sixty (60) calendar days for public sector operations. This information is disclosed on the Bank's website and is open to public comments. However, this does not substitute for the Client's obligation to identify stakeholders affected by or interested in the operation and to communicate with them in a meaningful way.

## Environmental and Social Monitoring

All the operations financed by the Bank are monitored against the agreed environmental and social compliance requirements in order to ensure that relevant environmental and social terms and conditions stipulated in the legal agreement are met, including implementation of ESAP. In addition to that, monitoring determines whether the prevention and mitigation measures employed to manage environmental and social risks and impacts are effective or need adjustments.

Monitoring of environmental and social aspects is based on the information provided by the Client in the annual environmental and social performance report, and information collected during the site visits, which are mandatory for Category A and B+ operations, and on a need basis for Category B operations. In case of complex operations with high risk environmental and social issues, the Bank or the Client may retain third party independent monitoring consultants to monitor the implementation of such operations.

## Selected Portfolio

Since the beginning, BSTDB favored operations with strong developmental impact, which create job opportunities, apply cleaner technologies and energy efficiency, and promote use of renewable sources. Over the years it has played an important role in efficiently minimizing the potential negative impacts on one hand, and enhancing the positive ones on the other. Among its financed operations some of them stand out for their environmental and social achievements.

Thus, in 2001 the Bank provided financing to the Kombinat za Czvetni Metali S.A. (KCM) zinc-lead smelter in Plovdiv for specific purposes of the ongoing environmental improvement program, without which, due to widespread contamination, the facility may have been restricted or even closed down. This could have resulted in major social issues as KCM was the largest employer and revenue generator in the area. BSTDB involvement was to finance installation of a central wastewater treatment plant, installation of closed cooling water cycles in the lead plant, modernization and expansions of the zinc cake filtering department. The Bank closely cooperated with the Client, authorities, research and NGO community in the area had put in place a comprehensive ESAP. Upon successful implementation this resulted in dramatic reduction of emissions and discharges and brought the facility into compliance with the legal and regulatory requirements, thus preventing production restrictions or closure. Other achieved benefits were the modernization of the basic production units to a level consistent with the widely accepted zinc and lead industry performance standards and increased levels of workers' health and safety.

Similarly, in 2003 BSTDB assisted the Russian leading steel producer Severstal in its efforts to modernize the production facilities and reduce its environmental and social negative impacts. Historically, these were associated with significant air emissions, large amounts of contaminated wastewaters, poor hazardous waste management practices, and weak occupational health and safety performance. Jointly with the Client the Bank put together with external assistance an ESAP, which upon implementation ensured higher compliance of Severstal with the applicable legal and regulatory requirements, it registered lower emission generation due to more efficient flue gas treatment, decreased water use and discharges, generated less solid wastes through improved recycling and fuel quality, as well as achieved lower occupational health and safety risks for workers, and improved its general environmental and social performance.

In 2004, the Bank started a fruitful cooperation with Galnaftogaz - one of Ukraine's leading players in the distribution of oil products, which continues up until present through repeat loans, in which BSTDB jointly with the Borrower managed to work closely on implementing a series of actions as part of agreed ESAPs that aimed at improving its environmental and social management system, pollution prevention and abatement of existing impacts associated with its gas stations and distribution network according to EU standards, and at upgrading its fuel storage facilities. Altogether this led to reduction of environmental, health and safety impacts and resulted in achieving higher compliance with the national norms and international good practices for gas stations operations and distribution networks.

BSTDB participation in 2006 and 2008 in urban transport development projects in Turkey, such as the Istanbul Metro and Electric Tramway and the light-rail transit system in Adana, will have a significant long-term positive environmental and social impact due to increased rail line passenger kilometers over highway passenger kilometers, both public and private, which as a result will reduce the rate of traffic accidents, fuel consumption and traffic jams, thus significantly reducing the urban air pollution and noise pollution, as well as decrease the urban land use for the purposes of building new roads, junctions and car parks.

In 2008 BSTDB joined Kurum Metallurgical Complex in Albania in its efforts to reduce the negative environmental and social impacts that were historically associated with the industry in the town of Elbasan. These ranged from excessive air pollution, due to employment of obsolete technological processes and inefficient pollution control, to poor in-house worker health & safety requirements and enforcement, and community health and safety, due to site contamination from past activities. The Bank closely assisted Kurum over the years in steadily improving its environmental and social performance by replacing and modernizing its key production units such as metal scrap processing, the melt shop, the rolling mills, the lime calcination plant, as well as by developing and implementing the appropriate environmental and social management systems at the plant. The established good cooperation with Kurum lasts until present through a number of repeat loans.

BSTDB participated in 2009 in a corporate loan to Petrom S.A – Romania leading integrated oil and gas company – aiming at financing the company's environmental investment program. It intended to increase the Company's overall environmental and social performance at the corporate level including its exploration, production and refining divisions. The specific environmental investments were targeting the past pollution clean-up, pipeline replacement, health and safety measures, energy efficiency and other environmental remediation investments. In addition, the project included financing of two corporate programs: development of a Road Safety Program applicable throughout the company and a Geographic Information System, which would allow rapid coordinated response to possible accidents or incidents, thereby minimizing possible impacts on health and safety and the environment.

2010 was earmarked by the Bank entering into its first wind project, namely participation in the development of a 60 MW Wind Farm in Suvorovo in Bulgaria. The investment is expected to have a long-term positive environmental impact, as it will reduce the GHG emissions and will contribute to the expansion of green energy markets in Bulgaria and assist the country in achieving its target of generating 16 % of its electricity consumed from renewable sources by 2020.

Co-financing in 2011 the 74 MW Koprubashi Hydroelectric Power Plant (HEPP) in Turkey was an environmentally and socially complex operation, in which the Bank carefully addressed such critical aspects as pollution prevention and abatement, labor and working conditions of the workforce involved, local communities health, safety and security, land acquisition and involuntary resettlement, biodiversity conservation and sustainable natural resources management. Upon commissioning, the operation resulted in such positive environmental impacts as generation of energy from non-polluting and renewable source and increased flood security of the downstream settlements, as well as new employment opportunities for the local workforce during the construction and operation stage of Koprubasi HEPP. The most critical issue however, which required very careful consideration, was related to resettlement of people from the future reservoir flood area. As part of the due diligence and monitoring the Bank made sure that resettlement was carried out according to the agreed Resettlement Plan and that the affected people were appropriately and fairly compensated for their lost income, access to resources, and households.

In 2014 BSTDB proudly entered

the photovoltaic renewable sector by participating in financing EDPR's six PV parks of 50.4 MW installed capacity in Romania. The Operation will contribute to the expansion of the renewable energy market in the country and will support achieving the target of sourcing 38% of its electricity consumed from renewable sources by 2020. As part of the agreed ESAP the Borrower has developed, implemented and certified its environmental and social management system according to ISO 14001 and OHSAS 18001, which will be applied at each PV park.

## Institutional and Implementation Aspects

All aspects of environmental and social sustainability of the Bank's financed operations are coordinated by the Environmental and Social Unit (DEU). It provides independent advisory, support and review functions on environmental and social risks and impacts, and works closely with business generating units in ensuring that the operations considered by the Bank for financing are sound and meet the requirements of its Environmental and Social Policy, and sustainable development principles the Bank has committed to follow. It also develops and implements relevant policies and procedures and participates in promotion of BSTDB activities through its website, social media, publications, meetings and forums.

BSTDB has committed to allocate the necessary resources in order to ensure that the environmental and social policy statements, its procedures and practices are effectively followed and implemented, fully integrated into its operation cycle, and are applied in a systematic manner to all the operations financed by the Bank.

## International Cooperation on Sustainability

BSTDB has established a long lasting and fruitful cooperation with governmental bodies from its Member States, partner Multilateral and Bilateral Financial Institutions, businesses, civil society, and general public, ensuring that its sustainable development objectives are met effectively, efficiently and in a transparent manner.

Since its establishment the Bank has been closely cooperating with its partner Multilateral Financial Institutions (MFI) within the Working Group on Environment and Social (WGES) issues. The WGES is a high level forum represented by the heads of environmental and social departments of all the MFIs and development agencies around the world, which aims at harmonizing the environmental and social assessment practices by sharing experiences, discussing issues of concern, developing common approaches, and working in partnership. BSTDB confirmed its dedication and increasing interest in the harmonization efforts by hosting two of the WGES meetings at its premises in Thessaloniki in May 2006 and in December 2011. These proved to be a very lucrative platform for addressing such topics of common MFI interest as policy developments, ecosystem services, climate change and harmonization, nuclear safety, challenges of desertification and land degradation, carbon markets, challenges in small-scale hydropower projects, sustainability reporting, risk management and climate change adaptation.

Similarly, BSTDB is actively involved at a European level in the European Development Finance Institutions (EDFIs) Working Group on Environmental and Social Issues. This is another high level forum that brings together all European Bilateral Financial Institutions in joining efforts to harmonize their environmental and social practices and achieve higher development effectiveness of their financing. In September 2010 the Bank had the privilege of hosting the EDFI Working Group on Environment and Social issues and the Development Effectiveness Working Group at its Headquarters. The forum debated over the issues of common EDFIs Environmental and Social Exclusion List, the Rome Consensus, climate change, development effectiveness reporting and indicators and harmonization of evaluation practices.

# Annual Evaluation Overview:

## Analysis of the Ex-Post Evaluation of Completed Operations

### A. Introduction

According to the BSTDB's Evaluation Policy, the Independent Evaluation Office of the Bank presents this annual evaluation overview to highlight key findings and trends from the conducted post-evaluations since 2000.

This overview and other evaluation products ensure accountability and quality management improvement of the Bank's performance, based on a rigorous, internationally harmonized independent evaluation of the BSTDB operations. Each annual evaluation overview is presented to the Management, the Board of Directors and the Board of Governors to highlight key findings and trends in operational and institutional performance.

The evaluation overviews aggregate and compare the findings of the conducted post-evaluations on an annual cumulative basis. They produce an overall picture of performance and reveal important trends and causal links. These reports do not contain commercially sensitive / operation-specific information and, therefore, represent the main vehicle for broader disclosure and accountability on the Bank's overall performance.

The annual evaluation overview presents a synthesis of the findings of the Bank's evaluated operations over the past 14 years, focusing on BSTDB's mandate fulfillment and overall performance. It preserves the corporate memory of the Bank by distilling the essence of "Lessons Learned" from the Bank's evaluations in a diversity of operations.

### B. Independent Evaluation: Methodology and Adherence to Highest IFI Standards

The BSTDB Post Evaluation Policy commits the independent evaluation to Good Practice Standards on Evaluation, as maintained by the Evaluation Cooperation Group (ECG) of the IFIs. These standards, inter alia, ensure the organizational and behavioral independence of the evaluation function, safeguarding the important accountability role of the evaluation for the Boards of Directors/ Governors. The Evaluation Office officially became an observer at ECG in 2010, when it started to maintain a pro-active role in enhancing and applying the respective IFI-specific standards in independent evaluation. In 2012 and 2013, the ECG, represented by IFC and EIB, performed a comprehensive peer review on the BSTDB's Evaluation Office, assessing its methodology, rigor and overall practice against the respective IFI standards. The review concluded that BSTDB meets the key standards on evaluation independence and made a number of enhancement recommendations that were implemented by BSTDB in 2013. Subsequently, in April 2014 the Bank's Independent Evaluation Office was officially admitted as a full member of ECG, acknowledging its commitment to highest IFI standards in evaluation.

The current Evaluation overview provides an overall picture of BSTDB performance over the period of 2000-2014, with a highlight of the latest trends and developments (2010-2014), based on the analysis of 92 evaluations of completed operations and a dozen of related evaluation studies.

The analysis covers three five-year periods, to smooth-out annual fluctuations, as required by the applicable evaluation methodology. The 2010-2014 data is compared with the target of reaching 70% positively performing sample of evaluated operations set in the Bank's Medium-Term Business Plan for 2011-2014.

The IFI-harmonized evaluation methodology uses 4 ratings for ranking performance of operations, 2 positive and 2 negative: Excellent, Satisfactory, Partially Unsatisfactory, Unsatisfactory. These ratings apply to each of the 5 evaluation criteria:

- RELEVANCE: Consistency of operation objectives with the BSTDB mandate;
- EFFECTIVENESS: Extent to which objectives are achieved;
- EFFICIENCY: Extent to which benefits are commensurate with inputs;
- SUSTAINABILITY: Likelihood that results will be maintained;
- INSTITUTIONAL IMPACT: Covers improvements in norms and practices.

The ratings on those 5 criteria form the overall rating, a single measure of overall operation's performance.

# C. Performance of Evaluated Operations Since 2000

## C.1 Overall Performance

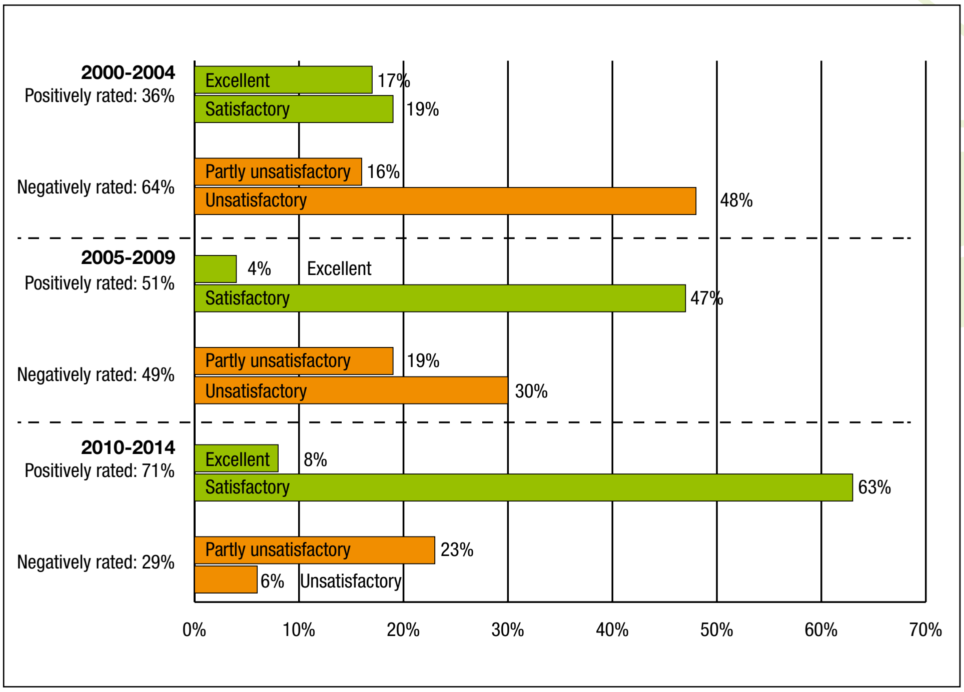
BSTDB has a positively rated (Excellent or Satisfactory) overall performance in 56% of all evaluated operations (2000-2014).

In the latest aggregate period (2010-2014) BSTDB's positively rated operations reached 71%, the highest level of all periods. This denotes a substantial positive trend (upwards from 36% in 2000-2004 and 51% in 2005-2007), indicating an achievement of the 70% target set in the Bank's Medium-Term Business Plan for 2011-2014.

On the upper end of the ratings, the share of "Excellent" ratings moved from 17% in 2000-2004, to 4% in 2004-2007 and 8% in 2010-2014.

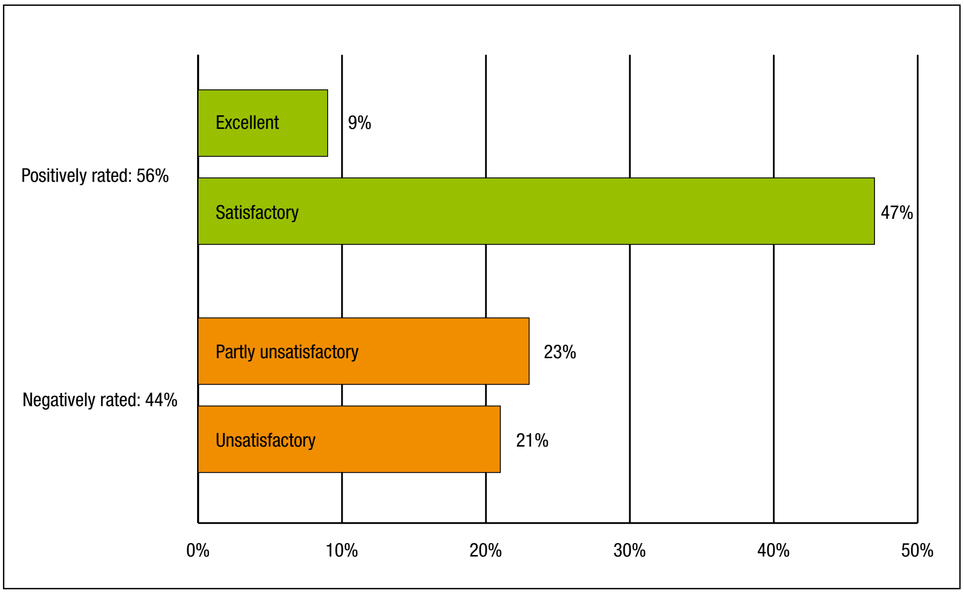
The share of BSTDB operations rated negatively (Partly Unsatisfactory or Unsatisfactory), indicates improvement, as the lowest-rated share (Unsatisfactory) decreased from 48% in 2000-2004 to just 6% in 2010-2014.

**Performance of Bank's operations for 2000-2004, 2005-2009, 2010-2014**



**Cumulative results for 2000-2014**

Sample of 92 operations, signed 2000-2008 (95% of all completed)

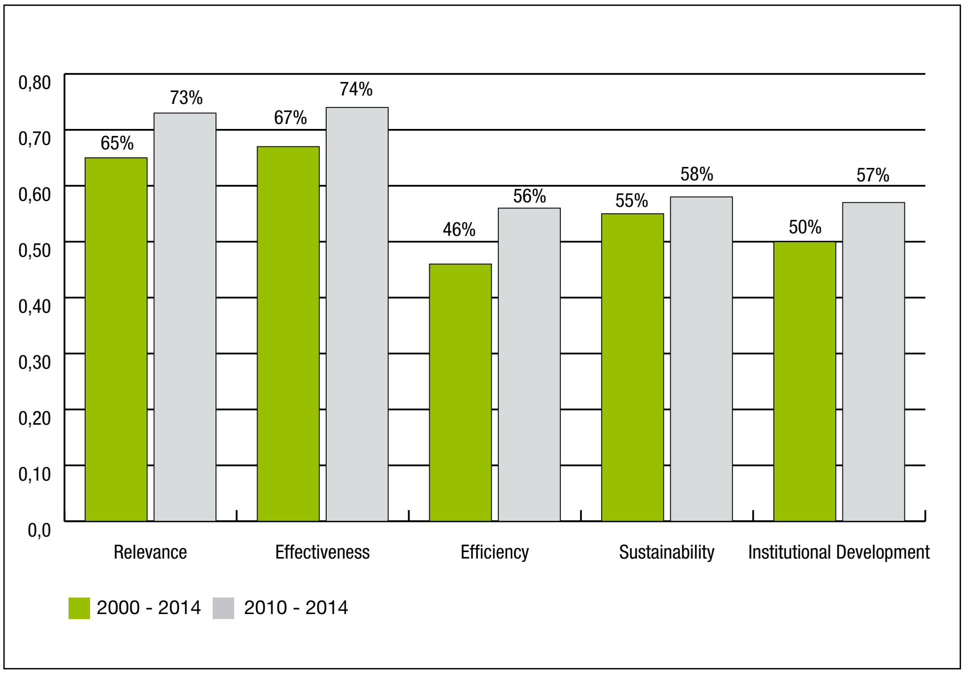



## C.2 Relevance, Effectiveness, Efficiency, Sustainability and Institutional Development

A more analytical review of the evaluation ratings under each of the five criteria (Relevance, Effectiveness, Efficiency, Sustainability and Institutional Development) is helpful to understand the broader picture, as well as where the Bank needs more efforts to enhance overall performance. An outline of the share of positively rated operations, out of all 92 evaluated operations since 2000, is presented below:

- Relevance of operations – 65% (2000-2014) and 73% (2010-2014) positively rated
- Effectiveness – 67% (2000-2014) and 74% (2010-2014) positively rated
- Efficiency – 46% (2000-2014) and 56% (2010-2014) positively rated
- Sustainability – 55% (2000-2014) and 58% (2010-2014) positively rated
- Institutional Development – 50% (2000-2014) and 57% (2010-2014) positively rated

**BSTDB'S PERFORMANCE 2000-2014**



## D. Independent Validation of Self-Evaluation Reports

The Bank's Operation Teams prepare self-evaluation reports on each operation (Operation Completion Reports - OCRs). The Independent Evaluation Office's evaluation normally differs in performance ratings relative to the ratings assigned by the operation teams in the respective OCRs. The divergence between the OCRs and the independent evaluations, expressed in binary terms (i.e. reflecting only the cases where the independent evaluation resulted in a change from positively rated self-evaluation to negatively rated[5], or vice-versa) is as follows:

- The overall OCR performance ratings on 92 operations were validated by the Evaluation Office without change in 60% of the cases.
- The OCR ratings that were upgraded and downgraded by the independent evaluation were 2% and 38% of the total, respectively.

## E. Follow-Up of Evaluation Recommendations

To date, all evaluation recommendations accepted by the Management have been either implemented or are under implementation. There are no outstanding issues.

## F. Conclusions

### F.1 Overall performance in line with the BSTDB Medium-Term Business Plan for 2011-2014

There is a clear upward trend, with the latest results (71%) being in line with the target of 70% positively rated operations set in the Bank's Medium-Term Business Plan for 2011-2014.

### F.2. Declining share of excellently rated operations deserves further attention

While overall performance increased over the years, the share of operations rated excellent has declined from 17% in the early years to 4-8% during the latest periods. This merits attention as highly successful operations are a key source of valuable learning and motivation. The diminishing cases of excellently rated operations reflect a combination of unrealistic expectations (driven by efforts to obtain approval) and lower achievement. There are several cases which imply that a closer alignment of operations with country analysis/strategies tends to deliver a higher number of outstanding performance, both at operational and institutional planes.

### F.3. Common causes for underperformance

The two most frequent key causes of underperformance are:

(i) Risks identified at due diligence are not always covered by adequate covenants and/or monitoring;

(ii) Mitigating the risk of poor corporate governance is very challenging, particularly when not done at the outset of operation handling.

### F.4. Incentive-based enhancement of self-evaluation quality

The quality of operational self-evaluations varies widely, exhibiting inadequate realism standards. Various measures for enhancement were already undertaken by the Evaluation Office and Management in the context of the Banks Performance Management Policy and are expected to improve quality of self-evaluations in the next periods.

### F.5. Comparisons with IFI peers

Since 2008, BSTDB maintains its performance generally in line with the comparable IFIs. The dramatic increase in the share of well-performing operations from 36% in 2004 to 71% in 2014, came as a result of proactive measures to analyze and mitigate shortfalls, such as volume-dominated incentives ("approval culture" - focusing on volumes of new operations with less effort on the quality and sustainability), as well as related waves of premature cancellations.

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[5] Positive: Excellent or satisfactory; Negative: Partly Unsatisfactory or Unsatisfactory

# Use of Resources

## Resources Management

### Human Resources

Human capital and staff resources are a key factor in the success of the BSTDB. The institution strives to maintain its status as a competitive employer, following international standards and best practices, applying meritocratic recruitment, and a remuneration system that promotes excellence.

### HR Policy Development

The year 2014 was marked by the update and implementation of several HR policies. A new remuneration policy was introduced, the benefits and allowance package was updated, and a trial period for the implementation of the new performance management system was initiated.

The revised remuneration policy marks a shift to a flexible and transparent broad-banding system. Intended to increase the fairness and transparency of human resources management, the policy promotes the institution's competitiveness in the labor market.

The benefits and allowances package was improved through the addition of an accommodation and education loans to the list of benefits available to eligible categories of staff, in line with the best practices of the other IFIs.

The new performance management system features increased objectivity, introduces performance-based rewards and links individual performance to the performance of the institution through a system of key performance indicators (KPIs). Institutional KPIs are cascaded down from the institutional to the departmental level and are included in the calculation of individual performance scores.

### Staffing and Recruitment

The BSTDB conducts recruitment on a wide geographical basis. While preference is given to citizens of the member countries, recruitment is competitive and is based on the professional qualifications of the candidates. At the end of 2014, BSTDB had 103 employees, from 13 member and non-member countries.

### Staff Development

The BSTDB offers learning opportunities, addressing the development needs of the staff within the organizational business requirements. The revised policy on training, learning and development establishes a clear link between the institution's business needs and the development of the staff. In 2014, staff training focused on professional and technical skills' development.

### 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 on preventive medical care. BSTDB also offers an optional post-separation medical coverage.

The BSTDB pension plan, launched in January 2003, comprises of a fully funded defined benefit pillar and a matched defined contribution component. This combination offers the necessary flexibility for best meeting the needs of a multi-national work force.

## Information Technologies

Technology is a critical and integral part of the BSTDB strategy. Improvements and developments on the IT infrastructure and major IT applications are continued and contribute to organizational efficiency and productivity.

Enhancements in the SAP system have been carried out in the areas of accounting, related to accruals for automatic posting and reporting based on IFRS standards.

During 2014, several new or updated segments have been created including:

- A section for the Global Emergency Risk Database (GEM) consortium, contributing information towards the strengthening of risk management practices;
- A website section providing information on potential investor interest;
- Restructuring of the Bank's information on operations under the Project Center area, drawing information from the Bank's SAP system; and
- A Dashboard application in the Enterprise Information Management (EIM) system enhancing communications and collaboration with the Board of Directors.

The Virtual Desktop Infrastructure (VDI) implementation has reached 95% completion, allowing staff to easily access their working environment from any location within the organization, from various types of devices, while the new remote access application implemented for Board members provides two-factor authentication. This application will be extended to Bank staff in 2015, allowing them to work remotely.

A new printing facility across the Bank has been introduced providing secure printing to staff. Staff can print and collect their document after entering a pin code at any network printer.

The VDI technology and the new printing facility have allowed the Bank to reduce energy use and printing consumables.

## External Relations and Communications

During 2014, BSTDB's activities in external relations focused on promoting the corporate image and awareness of the Bank under an action plan to mark the 15th anniversary of BSTDB operations. Enhanced cooperation with member states' governments, the development community, and business circles supported the Bank's strategy and business objectives.

### Interaction with the Development Community

BSTDB maintained active participation in consultations with peer IFIs and international development institutions to facilitate knowledge sharing and promote developmental effectiveness.

In April 2014, BSTDB became an official member of the IFIs' Evaluation Cooperation Group, the authority on independent evaluation and related best practice standards.

As in previous years, BSTDB contributed to discussions among international financial institutions and development banks. The Bank actively participated in the IFIs' Annual Meeting on Corporate Governance, Heads of Procurement, the working groups of IFI Secretaries, and on Information Disclosure.

The Bank continued as an active member of the Interact Group of the Association of the European Development Finance Institutions (EDFI) and the Institute of International Finance (IIF).

### Support for Regional Cooperation

BSTDB contributed to the development agendas of the Organization of the Black Sea Economic Cooperation (BSEC), the Parliamentary Assembly of BSEC, the Business Council of BSEC, and the International Centre of Black Sea Studies.

On the occasion of the 2014 BSTDB Annual Meeting in Sofia, the Bank marked the 15th anniversary of its operations. A Business Forum was held in cooperation with the Bulgarian government and development financial institutions, on the challenges and opportunities of cross-border investment in the Black Sea region. Business development sessions, organized in partnership with the Bulgarian Development Bank, gave the opportunity to business participants to discuss trade and investment opportunities in Bulgaria and the wider Region.

## Administrative Services

During 2014, the Administrative Services Department continued efforts to improve the overall efficiency of the department and provide higher quality services to the Bank staff. The department implemented substantial changes in the Bank's facilities and rationalized arrangements to achieve improved service with smaller resources.

# Financial Management

## Business Volume

In 2014, the Bank's total assets were EUR 1,057,063 thousand at the end of the year against EUR 932,198 thousand at end 2013, representing a 13% expansion. The Bank increased the size of the outstanding loan and equity portfolios to EUR 961,982 thousand compared to EUR 779,339 thousand in the previous year, an increase of nearly 24%. Funds committed but not yet disbursed stood at EUR 90,860 thousand at the end of the year.

## Revenues

Interest income from lending activities was EUR 39,854 thousand for the year, from EUR 38,282 thousand in 2013. Treasury activities in 2014 generated interest income of EUR 1,964 thousand from its investment portfolios. Operating income for the year was EUR 32,718 thousand compared to EUR 28,774 thousand in 2013.

## Expenses

Interest and similar expense for the year was EUR 11,705 thousand compared to EUR 12,495 thousand in 2013. This decrease was due principally to the lower borrowing costs resulting from lower than anticipated base interest rates and the Bank having market access to more favorable priced funds.

Administrative expenses in 2014, including depreciation, were EUR 17,292 thousand, an increase of only EUR 373 thousand over the previous year. Administrative expenses include salaries, benefits, and other administrative costs.

Personnel expenses, to the amount of EUR 13,074 thousand, showed an increase of EUR 400 thousand from the previous year. Other administrative costs also had a slight decrease from the previous year to an amount of EUR 132 thousand.

Overall, administrative expenses were well within the 2014 Budget, reflecting the Bank's focus on budgetary discipline and effective cost controls.

## Net Income

Income before impairment during the year was EUR 15,426 thousand compared to EUR 11,855 thousand in 2013. Net impairment losses to an amount of EUR 1,403 thousand were due to an increase of specific provision in one of the Bank's existing operation that was partially offset by the decrease in the general provisions.

The Bank posted a net income of EUR 14,023 thousand for the year, while the quality of the lending portfolio remained sound, experiencing no additional impaired loan operations.

# Capital Base

## Initial Share Capital

The initial authorized share capital of the Bank was EUR 1.15 billion divided into one million shares having a par value of EUR 1,150 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 EUR 34.5 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 EUR 1.15 billion to EUR 3.45 billion. They further approved a EUR 1.15 billion increase in the subscribed capital to be subscribed by the existing Member States, thereby increasing subscribed capital to EUR 2.3 billion. An announcement that this additional EUR 1.15 billion was fully subscribed was made after the Board of Governors meeting in October 2008. Georgia declined to take up its 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, the Board of Governors accepted Moldova's request and reduced its portion of the subscribed capital, from 1% to 0.5%, and, therefore, those shares were released to unallocated.

The new subscribed capital was to 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 EUR 114 million), was to be paid 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 EUR 228 million), was to be made by each Member State in eight equal successive annual installments between 2011 and 2018.
- Payment for the remaining callable portion of the new subscribed capital, equivalent to 70% of the shares (totaling EUR 797 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 2014 the paid in share capital was EUR 543 million.

The Board of Governors may also authorize additional subscriptions from the remaining EUR 1.15 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 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 2014 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 2.3 billion.

## Provisioning

Provisions are recorded in two ways:

- General provisioning rate applied to the entire portfolio.
- Specific provisions are applied against certain assets and are 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 2014, total provisions for loans stood at EUR 47,734 thousand, equivalent to 5.4% 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.

## 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 growth of 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

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

operations, it would, with the use of SA, amount to EUR 7.6 million for 2014 and EUR 7.8 million for 2013, 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, at least, all potential losses arising from events of an operational risk nature. Consequently, there is no need, for operational risk purposes, to make supplementary allocations. It is noted that the Establishing Agreement requires the Bank to maintain reserves at a relatively high percentage of its portfolio[2].

## Short-Term Liquidity

As indicated in the statement of cash flows, the Bank's short term liquidity totaling EUR 128,955 thousand as of 31 December 2014 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, stood at 112% on 31 December 2014.

## Borrowings Utilized

As of the end of 2014, 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, which had outstanding amounts equivalent to EUR 91,865 thousand and USD 100,856 thousand. As the size of the Bank's operations portfolio continues to increase, and taking into consideration its minimum liquidity requirements, the Bank might access sources of long term funds in 2015.

The Bank has a long term investment grade credit rating from Moody's Investor Service of A2 and a short term rating of P1. The Bank also has a long term investment grade credit rating from Standard and Poor's Investor Service of A- and a short term rating of A2.

## 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.

## 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.

[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 (Article 36 – Allocation of Net Income).

## Independent Evaluation

The Bank conducts assessments of completed and current operations, programs, activities and strategies through rigorous systematic analyses, according to highest international standards. The 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.

The Independent Evaluation Office is an official member of the Evaluation Cooperation Group of the International Financial Institutions and adheres to all applicable good practice standards and peer reviews of the Group. It conducts various evaluation studies and reports all key findings and recommendations to the Board of Governors and Board of Directors, as well as other stakeholders via the Bank's Annual Report.

The Evaluation Office manages a database of lessons learned from internal and external evaluations, in order to enhance the quality and risk-resilience of new operations. It also maintains various forms of cooperation with similar institutions on methods, practices and insights.

## Preferred Creditor Status

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

- 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 (DCR) 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 internal integrity issues, DCR monitors, administers and advises on Code of Conduct-related issues for Bank Officials and staff.

With regard to the financing operations, anti-fraud, corruption, money laundering, terrorism financing and sanctions due diligence are – 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 advises the business groups, as needed, inter alia, on the Customer Due Diligence process and integrity issues.

## 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 is 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, further renewable 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 2014

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 deemed 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 2014. 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 2014, the Bank maintained effective internal controls over its financial reporting as contained in the Financial Statements for 2014.

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.

**Ihsan Ugur Delikanli**
President

**Valentina Siclovan**
Vice President, Finance

**Black Sea Trade and Development Bank**
Thessaloniki
24 April 2015

# 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 2014, 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 includes 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 authorisations 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 2014, based on the COSO criteria.

24 April 2015
**KPMG Certified Auditors A.E.**
**Athens, Greece**

# Income Statement

## For the year ended 31 December 2014

| Presented in thousands of EUR | Note | 2014 | 2013 |
|---|---|---|---|
| Interest income | 7 | 41,818 | 40,303 |
| Interest expense | 8 | (11,705) | (12,495) |
| **Net interest income** | | **30,113** | **27,808** |
| Net fees and commissions | 9 | 635 | 538 |
| Dividend income | 15 | 1,690 | 1,203 |
| Net (losses) from debt investment securities | | (179) | (47) |
| Net profit on purchase of loan | | 528 | - |
| Foreign exchange losses | | (95) | (748) |
| Other income | | 26 | 20 |
| **Operating income** | | **32,718** | **28,774** |
| Personnel expenses | 10,25 | (13,074) | (12,674) |
| Other administrative expenses | 10 | (3,453) | (3,585) |
| Depreciation and amortization | 17,18 | (765) | (660) |
| **Income before impairment** | | **15,426** | **11,855** |
| Impairment (losses) on loans | 11 | (1,406) | (665) |
| Impairment gains (losses) on guarantees | | 3 | (10) |
| Impairment gains on debt investment securities | | - | 2,104 |
| **Net income for the year** | | **14,023** | **13,284** |

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

# Statement of other Comprehensive Income

For the year ended 31 December 2014

| Presented in thousands of EUR | Note | 2014 | 2013 |
|---|---|---|---|
| Net income for the year | | 14,023 | 13,284 |
| Other comprehensive income: | | | |
| Items that will not be reclassified to profit or loss: | | | |
| Remeasurements of defined benefit liability (asset) | 23 | (4,318) | 331 |
| Items that are or may be reclassified to profit or loss: | | | |
| Net change in available-for-sale financial assets | 23 | 19,436 | 1,428 |
| Net amount transferred to profit or loss | | - | 1 |
| **Total comprehensive income for the year** | | **29,141** | **15,044** |

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

# Statement of Financial Position

## At 31 December 2014

| Presented in thousands of EUR | Note | 2014 | 2013 |
|---|---|---|---|
| **Assets** | | | |
| Cash and cash equivalents | 24 | 63,955 | 14,849 |
| Debt investment securities: | | | |
| Available-for-sale | 12,24 | 75,016 | 157,812 |
| Derivative financial instruments – assets | 13 | - | 16,210 |
| Loans | 14,16 | 877,122 | 726,405 |
| Less: deferred income | 14 | (8,125) | (6,146) |
| Less: impairment losses | 11,14 | (47,734) | (41,163) |
| Loans net of impairment | | 821,263 | 679,096 |
| Equity investments available-for-sale | 15,16 | 84,860 | 52,934 |
| Property and equipment | 17 | 756 | 805 |
| Intangible assets | 18 | 414 | 660 |
| Other assets | 19 | 10,799 | 9,832 |
| **Total Assets** | | **1,057,063** | **932,198** |
| **Liabilities** | | | |
| Borrowings | 20 | 341,215 | 286,344 |
| Derivative financial instruments – liabilities | 13 | 11,769 | - |
| Payables and accrued interest | | 8,968 | 4,761 |
| Total liabilities | | 361,952 | 291,105 |
| **Members' Equity** | | | |
| Authorized share capital | 22 | 3,450,000 | 3,450,000 |
| Less: unallocated share capital | 22 | (1,161,500) | (1,161,500) |
| Subscribed share capital | 22 | 2,288,500 | 2,288,500 |
| Less: callable share capital | 22 | (1,601,950) | (1,601,950) |
| Less: payable share capital | 22 | (143,702) | (168,584) |
| Advance against future call | 22 | - | 5 |
| Paid-in share capital | | 542,848 | 517,971 |
| Reserves | 23 | 71,389 | 50,519 |
| Retained earnings | | 80,874 | 72,603 |
| Total members' equity | | 695,111 | 641,093 |
| **Total Liabilities and Members' Equity** | | **1,057,063** | **932,198** |

| | | | |
|---|---|---|---|
| **Off-balance-sheet items** | | | |
| Commitments | 16 | 90,860 | 148,146 |

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

# Statement of Changes in Members' Equity

For the year ended 31 December 2014

| Presented in thousands EUR | Share capital | | | | | |
|---|---|---|---|---|---|---|
| | Sub-scribed | Callable | Payable | Reserves | Retained earnings | Total |
| **At 31 December 2012** | **2,316,688** | **(1,623,876)** | **(198,420)** | **41,902** | **62,589** | **598,883** |
| **Total comprehensive income** | | | | | | |
| Net income for the year | - | - | - | - | 13,284 | 13,284 |
| Other comprehensive income: | | | | | | |
| Fair value reserve (available-for-sale financial assets) | - | - | - | 1,429 | - | 1,429 |
| Remeasurement of defined benefit liability (asset) | - | - | - | 331 | - | 331 |
| Total comprehensive income | - | - | - | 1,760 | 13,284 | 15,044 |
| **Transactions with owners of the Bank** | | | | | | |
| Members' contributions: | | | | | | |
| Paid-in share capital | - | - | 23,248 | - | - | 23,248 |
| Cumulative translation adjm. | (28,188) | 21,926 | 6,599 | 3,587 | - | 3,924 |
| Advance against future call | - | - | (6) | - | - | (6) |
| Transfer to general reserve | - | - | - | 3,270 | (3,270) | - |
| Total contributions and distributions | (28,188) | 21,926 | 29,841 | 6,857 | (3,270) | 27,166 |
| **At 31 December 2013** | **2,288,500** | **(1,601,950)** | **(168,579)** | **50,519** | **72,603** | **641,093** |
| **Total comprehensive income** | | | | | | |
| Net income for the year | - | - | - | - | 14,023 | 14,023 |
| Other comprehensive income: | | | | | | |
| Fair value reserve (available-for-sale financial assets) | - | - | - | 19,500 | (64) | 19,436 |
| Remeasurement of defined benefit liability (asset) | - | - | - | (4,318) | - | (4,318) |
| Total comprehensive income | - | - | - | 15,182 | 13,959 | 29,141 |
| **Transactions with owners of the Bank** | | | | | | |
| Members' contributions: | | | | | | |
| Paid-in share capital | - | - | 24,882 | - | - | 24,882 |
| Advance against future call | - | - | (5) | - | - | (5) |
| Transfer to general reserve | - | - | - | 5,688 | (5,688) | - |
| Total contributions and distributions | - | - | 24,877 | 5,688 | (5,688) | 24,877 |
| **At 31 December 2014** | **2,288,500** | **(1,601,950)** | **(143,702)** | **71,389** | **80,874** | **695,111** |

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

# Statement of Cash Flows

## For the year ended 31 December 2014

| Presented in thousands of EUR | Note | 2014 | 2013 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Net income for the year | | 14,023 | 13,284 |
| Adjustment for: | | | |
| Impairment losses (gains) | | 1,403 | (1,429) |
| Depreciation and amortization | | 765 | 660 |
| Net interest income | | (30,113) | (27,808) |
| Dividends on available-for-sale securities | | (1,690) | (1,203) |
| Foreign exchange adjustment on provisions | | 5,165 | (1,528) |
| Operating income before changes in operating assets | | (10,447) | (18,024) |
| Changes in: | | | |
| Derivative financial instruments | | 27,979 | (4,693) |
| Other assets | | 22 | 1,204 |
| Accounts payable | | 4,341 | (3,040) |
| Deferred income | | 1,979 | (548) |
| Fair value movements | | 19,500 | 1,429 |
| Cash generated from operations | | 43,374 | (23,672) |
| Proceeds from repayment of loans | | 180,720 | 188,821 |
| Proceeds from repayment of equity investments | | 3,656 | 475 |
| Funds advanced for loans | | (283,147) | (193,085) |
| Funds advanced for equity investments | | (12,109) | (7,984) |
| Foreign exchange and other adjustments | | (71,763) | 20,772 |
| Interest income received | | 40,829 | 40,945 |
| Dividends received | | 1,690 | 1,203 |
| Interest expense paid | | (11,836) | (13,050) |
| Net cash from / (used in) operating activities | | (108,586) | 14,425 |
| **Cash flows from investing activities** | | | |
| Proceeds from available-for-sale investment securities | | 21,588 | 7,921 |
| Purchase of available-for-sale investment securities | | (23,174) | (2,770) |
| Purchase of property, software and equipment | | (470) | (609) |
| Net cash from / (used in) investing activities | | (2,056) | 4,542 |
| **Cash flows from financing activities** | | | |
| Proceeds received from share capital | | 24,882 | 23,248 |
| Exchange rate difference on conversion | | - | 3,924 |
| Decrease in advance against future call | | (5) | (6) |
| Paid-in share capital received | | 24,877 | 27,166 |
| Proceeds from borrowings | | 117,377 | 13,420 |
| Repayments of borrowings | | (62,506) | (100,431) |
| Net cash from / (used in) financing activities | | 79,748 | (59,845) |
| **Net (decrease) in cash and cash equivalents** | | **(30,894)** | **(40,878)** |
| Cash and cash equivalents at beginning of year | | 159,849 | 200,727 |
| **Cash and cash equivalents at end of year** | 24 | **128,955** | **159,849** |

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 financial position date 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 the year ended 2014 were submitted by the Management Committee to the Board of Directors ("BoD") for approval on 24 April 2015, 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 21 June 2015.

### Basis of Measurement

The financial statements have been prepared on a historical cost basis except for the available for sale financial assets and derivative contracts, which are measured at fair value.

### 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.

### 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

A summary of the Bank's accounting policies applied in the preparation of these financial statements is presented in this section. These policies have been consistently applied to all periods presented in the financial statements, 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 denominated in foreign currencies at the end of year, are recorded in the income statement.

The Bank uses the official exchange rates published for the EUR by the ECB. The exchange rates used by the Bank at the financial position date were as follows.

| | | | 31 December 2014 | 31 December 2013 |
|---|---|---|---|---|
| | = | United States dollar | 1.21410 | 1.37910 |
| 1 EUR | = | Pound sterling | 0.77890 | 0.83370 |
| | = | Azerbaijan manat | 0.94740 | 1.07650 |

### Recognition and Derecognition of Financial Instruments

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

The Bank derecognizes a financial asset or a portion of financial asset 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 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 of change in value due to the movements in market rates.

### 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 other fees and relating income generated are reported in the income statement (see note 9).

#### 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. 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, Euro Commercial Paper (“ECP”) or bonds are classified as available-for-sale and 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 assets where there is no active market, the fair value is determined using accepted valuation techniques. These valuation techniques used are net asset value and earnings-based valuations using comparable information and discounting cash flows.

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 measured initially 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 the income statement using the effective interest rate method.

#### b) Other liabilities

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.

### Offsetting of Financial Assets and Liabilities

Offsetting 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 derivative transactions which meet specified criteria relative to debt securities 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 basis.

The Bank documents the relationship between hedging instruments and hedged items upon initial recognition of the transaction.

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. At 31 December 2014 the Bank did not have any cash flow hedge.

#### i) Fair value hedge

Changes in the fair value of the derivatives that are designated and qualify as fair value hedges and 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.

## 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, or
- 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 as impaired. The amount of the loss is measured as the difference between the carrying amount of the asset 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 internally 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 the income statement.

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. The Bank's analysis 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 recognized while a guarantee is in effect and the amounts are determined based on the level of utilization of the guarantee. 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 at least 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 highest 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 all Member Countries. 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 also included and elaborated upon in Article 12 of the Headquarters Agreement with the Hellenic Government, ratified by Greek Law 2380/No.38/7.3.1996.

## Provisions

The Bank raises 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 income 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 performed annually by qualified, independent actuaries. Actuarial and asset gains or losses are recognized in "Other comprehensive income", and net gains or losses are included in remeasurements where any change in the effect of the asset ceiling, excluding those amounts that have been already included in personnel expenses, are also included.
- 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, 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 are 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 in 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.

## 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 during which the termination takes place.

## New and Forthcoming Accounting Standards

### a) New currently effective requirements

The accounting policies have been consistently applied to all periods presented in the financial statements.

The new standards and amendments to standards, including any consequential amendments to other standards, with a date of application of 1 January 2014, did not have an impact on the Bank's financial statements.

### b) Forthcoming requirements

A number of new standards and amendments to standards are effective for annual periods beginning after 1 January 2014; however, the Bank has not applied the following new or amended standards in preparing these financial statements.

- IFRS 9 Financial Instruments which is effective for annual reporting periods beginning on or after 1 January 2018.
- IFRS 15 Revenue from Contracts from Customers which is effective for annual reporting periods beginning on or after 1 January 2017.
- Defined Benefit Plans: Employee Contributions (Amendment to IAS 19).
- Annual Improvements to IFRS's 2010-2012 Cycle.
- Annual Improvements to IFRS's 2011-2013 Cycle.
- Annual Improvements to IFRS's 2012-2014 Cycle – various standards.
- IFRS 14 Regulatory Deferred Accounts.
- Accounting for Acquisition of Interests in Joint Operations (Amendments to IFRS 11).
- Clarification of Acceptable Methods of Depreciation and Amortization (Amendments to IAS 16 and IAS 38).
- Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41).
- Equity Method in Separate Financial Statements (Amendments to IAS 27).
- Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28).
- Consolidated Financial Statements (Amendment to IFRS 10).
- Disclosure of Interests in Other Entities (Amendment to IFRS 12).
- Investments in Associates and Joint Venture: Investment Entities: Applying the Consolidation Exception (Amendments to IAS 28).
- Amendments to International Accounting Standard 1 "Presentation of Financial Statements": Disclosure Initiative.

A number of the above new or amended standards permit early adoption, but the Bank has not chosen to do so.

The Bank is assessing the potential impact on its financial statements resulting from the application of IFRS 9, IFRS 15 and the Amendment to International Accounting Standard 1. The remaining new or amended standards noted above are not expected to have a significant impact on the Bank's financial statements.

# 4. Use of 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 6,947 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.

  Furthermore, there was an increase on specific provisions during the year made for the identified impairment of EUR 6,336 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.
- 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 25. 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 like the EUR and USD. The Bank's liability to the staff retirement plan at 31 December 2014 was EUR 4,664 thousand.

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

# 5. Risk Management

Risk is inherent in the Bank's activities and is managed through an ongoing process of identification, measurement and monitoring, as well as being 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 Policy Document defines that risk parameters 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 whereby 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 default rate, recovery rate and sector risk analysis provided by the GEMs risk database (see section of the accounting policies: Impairment). Default and Loss Given Default data is updated annually and provides objective evidence of impairment, using separately each operation's risk profile and adjusting it for current circumstances, when necessary.

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 Department 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 2014 | At 31 December 2013 |
|---|---:|---:|
| Cash and bank balances | 63,955 | 14,849 |
| Debt investment securities | 75,016 | 157,812 |
| Derivative financial instruments | - | 16,210 |
| Loans | 877,122 | 726,405 |
| Equity investments | 84,860 | 52,934 |
| Other assets | 10,799 | 9,832 |
| **On-balance-sheet** | **1,111,752** | **978,042** |
| Undrawn commitments | 90,860 | 148,146 |
| **Total** | **1,202,612** | **1,126,188** |

## b) Analysis by rating agency

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

2014

| Presented in EUR (000) | Aaa – Aa3 | A1 – A3 | Baa1 – Baa3 | Unrated | **Total** |
|---|---|---|---|---|---|
| Analysis by Moody's rating | | | | | |
| Cash and bank balances | 63,955 | - | - | - | **63,955** |
| Debt investment securities | - | 75,016 | - | - | **75,016** |
| Equity investments | - | - | - | 84,860 | **84,860** |
| **At 31 December** | **63,955** | **75,016** | **-** | **84,860** | **223,831** |
| Of which issued by | | | | | |
| Governments | - | - | - | - | **-** |
| Corporates | - | 75,016 | - | 84,860 | **159,876** |
| Deposits at banks | 63,955 | - | - | - | **63,955** |
| **At 31 December** | **63,955** | **75,016** | **-** | **84,860** | **223,831** |
| Of which classified as | | | | | |
| Available-for-sale | - | 75,016 | - | 84,860 | **159,876** |
| Held-to-maturity | - | - | - | - | **-** |
| Amortized cost | 63,955 | - | - | - | **63,955** |
| **At 31 December** | **63,955** | **75,016** | **-** | **84,860** | **223,831** |

2013

| Presented in EUR (000) | Aaa – Aa3 | A1 – A3 | Baa1 – Baa3 | Unrated | **Total** |
|---|---|---|---|---|---|
| Analysis by Moody's rating | | | | | |
| Cash and bank balances | 14,849 | - | - | - | **14,849** |
| Debt investment securities | 1,502 | 145,000 | 11,310 | - | **157,812** |
| Equity investments | - | - | - | 52,934 | **52,934** |
| **At 31 December** | **16,351** | **145,000** | **11,310** | **52,934** | **225,595** |
| Of which issued by | | | | | |
| Governments | 1,502 | - | - | - | **1,502** |
| Corporates | - | 145,000 | 11,310 | 52,934 | **209,244** |
| Deposits at banks | 14,849 | - | - | - | **14,849** |
| **At 31 December** | **16,351** | **145,000** | **11,310** | **52,934** | **225,595** |
| Of which classified as | | | | | |
| Available-for-sale | 1,502 | 145,000 | 11,310 | 52,934 | **210,746** |
| Held-to-maturity | - | - | - | - | **-** |
| Amortized cost | 14,849 | - | - | - | **14,849** |
| **At 31 December** | **16,351** | **145,000** | **11,310** | **52,934** | **225,595** |

### c) Credit risk in loans portfolio

The tables below provide an analysis of the Bank's internal probability of default rating scale from 1 (lowest risk) to 15 (highest risk) and how it corresponds to the external ratings of Moody's credit rating service. Most of the Bank's loans as of the financial position date were externally rated by a major credit rating investor services.

| Risk rating | Internal risk rating category | External rating equivalent | Grade of investment |
|---|---|---|---|
| 1 | Excellent | Aaa | Investment |
| 1 | Very strong | Aa1 – Aa3 | Investment |
| 2 | Strong | A1 – A3 | Investment |
| 3,4,5 | Good | Baa1 – Baa3 | Investment |
| 6,7,8 | Fair | Ba1 – Ba3 | Investment |
| 9,10,11 | Weak | B1 – B3 | Investment |
| 12,13,14 | Special attention | Caa1 –Caa3 | Classified |
| 15 | Expected loss | Ca – C | Classified |

Loans that are neither past due nor impaired are categorized as standard within collective impairment, and those loans that are individually identified as impaired are categorized within specific impairment (see note 14 for further analysis).

| | Presented in EUR (000) | | | | | | |
|---|---|---|---|---|---|---|---|
| Internal risk rating category | Neither past due nor impaired | Past due but not impaired | Impaired | **Total** | Collective provisions for impairment | Specific provisions for impairment | **Total** |
| Excellent | - | - | - | **-** | - | - | **-** |
| Very strong | - | - | - | **-** | - | - | **-** |
| Strong | - | - | - | **-** | - | - | **-** |
| Good | 95,507 | - | - | **95,507** | 812 | - | **812** |
| Fair | 307,613 | - | - | **307,613** | 2,615 | - | **2,615** |
| Weak | 414,105 | - | - | **414,105** | 3,520 | - | **3,520** |
| Special attention | - | - | 11,470 | **11,470** | - | 2,883 | **2,883** |
| Expected loss | - | - | 48,427 | **48,427** | - | 37,904 | **37,904** |
| **At 31 December 2014** | **817,225** | **-** | **59,897** | **877,122** | **6,947** | **40,787** | **47,734** |

| | Presented in EUR (000) | | | | | | |
|---|---|---|---|---|---|---|---|
| Internal risk rating category | Neither past due nor impaired | Past due but not impaired | Impaired | **Total** | Collective provisions for impairment | Specific provisions for impairment | **Total** |
| Excellent | - | - | - | **-** | - | - | **-** |
| Very strong | - | - | - | **-** | - | - | **-** |
| Strong | - | - | - | **-** | - | - | **-** |
| Good | 168,659 | - | - | **168,659** | 2,383 | - | **2,383** |
| Fair | 195,621 | - | - | **195,621** | 2,764 | - | **2,764** |
| Weak | 294,064 | - | - | **294,064** | 4,156 | - | **4,156** |
| Special attention | - | - | 27,712 | **27,712** | - | 4,745 | **4,745** |
| Expected loss | - | - | 40,349 | **40,349** | - | 27,115 | **27,115** |
| **At 31 December 2013** | **658,344** | **-** | **68,061** | **726,405** | **9,303** | **31,860** | **41,163** |

### d) 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, guarantees, covenants and comfort letters.

- Loans and advances. The Board of Directors approved guidelines for taking security under lending operations, set the levels and types of collateral and other credit enhancements recommended for a given risk profile.
  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. Bonds and Euro Commercial Paper held by the Bank as investment securities, are generally unsecured. The Bank may hold cash or government securities as collateral against its derivative contract counterparties. At 31 December 2014 the Bank holds cash collateral an amount of EUR 10,230 thousand (2013: EUR -11,438 thousand).

### e) 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 include estimated interest amounts, 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 | - | 1,319 | 51,979 | 288,545 | 24,336 | **366,179** |
| Derivative financial instruments | - | 11,769 | - | - | - | **11,769** |
| Payables and accrued interest | - | 4,304 | 4,664 | - | - | **8,968** |
| **Financial Liabilities at 31 December 2014** | **-** | **17,392** | **56,643** | **288,545** | **24,336** | **386,916** |
| Borrowings | - | 1,429 | 49,703 | 244,205 | 15,410 | **310,747** |
| Payables and accrued interest | - | 4,640 | 121 | - | - | **4,761** |
| **Financial Liabilities at 31 December 2013** | **-** | **6,069** | **49,824** | **244,205** | **15,410** | **315,508** |

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 possibility 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 assets 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 on 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 | Swiss franc | Other * | **Total** |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and bank balances | 58,767 | 5,174 | - | 14 | **63,955** |
| Debt investment securities | 75,016 | - | - | - | **75,016** |
| Loans | 446,347 | 430,775 | - | - | **877,122** |
| Deferred income | (5,469) | (2,656) | - | - | **(8,125)** |
| Impairment losses on loans | (3,794) | (43,940) | - | - | **(47,734)** |
| Equity investments | 27,656 | 11,967 | - | 45,237 | **84,860** |
| Other assets | 4,822 | 4,962 | 954 | 61 | **10,799** |
| Total | 603,345 | 406,282 | 954 | 45,312 | **1,055,893** |
| **Liabilities** | | | | | |
| Borrowings | 91,865 | 83,071 | 166,279 | - | **341,215** |
| Derivative financial instruments | 11,769 | - | - | - | **11,769** |
| Payables and accrued interest | 6,109 | 1,850 | 1,009 | - | **8,968** |
| Total | 109,743 | 84,921 | 167,288 | - | **361,952** |
| Net financial instruments | 493,602 | 321,361 | (166,334) | 45,312 | **693,941** |
| Derivative financial instruments | 173,769 | (339,816) | 166,334 | - | **287** |
| **Currency balance at 31 December 2014** | **667,371** | **(18,455)** | **-** | **45,312** | **694,228** |

* Primarily represents the Access Bank equity investment which is denominated in Azerbaijan manats. This exposure is not hedgeable at reasonable cost. To partially offset the manat assets the Bank holds reserves of EUR 27,287 thousand leaving a net foreign exchange exposure to the manat of EUR 18,025 thousand (2013: EUR 15,853 thousand).

| Presented in EUR (000) | Euro | United States dollar | Swiss franc | Other * | Total |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Cash and bank balances | 8,886 | 5,950 | - | 13 | **14,849** |
| Debt investment securities | 146,502 | 11,310 | - | - | **157,812** |
| Derivative financial instruments | 16,210 | - | - | - | **16,210** |
| Loans | 376,111 | 350,294 | - | - | **726,405** |
| Deferred income | (3,888) | (2,258) | - | - | **(6,146)** |
| Impairment losses on loans | (7,225) | (33,938) | - | - | **(41,163)** |
| Equity investments | 21,164 | 10,573 | - | 21,197 | **52,934** |
| Other assets | 4,201 | 4,670 | 904 | 57 | **9,832** |
| Total | 561,961 | 346,601 | 904 | 21,267 | **930,733** |
| **Liabilities** | | | | | |
| Borrowings | 86,219 | 37,291 | 162,834 | - | **286,344** |
| Payables and accrued interest | 2,140 | 1,618 | 988 | 15 | **4,761** |
| Total | 88,359 | 38,909 | 163,822 | 15 | **291,105** |
| Net financial instruments | 473,602 | 307,692 | (162,918) | 21,252 | **639,628** |
| Derivative financial instruments | 159,186 | (321,796) | 162,918 | - | **308** |
| **Currency balance at 31 December 2013** | **632,788** | **(14,104)** | **-** | **21,252** | **639,936** |

* Primarily represents the Access Bank equity investment which is denominated in Azerbaijan manats (see above).

### 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.

| | Interest bearing | | | | | |
|---|---|---|---|---|---|---|
| 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 | Non-interest bearing | Total |
| **Assets** | | | | | | |
| Cash and bank balances | 63,953 | - | - | - | 2 | **63,955** |
| Debt investment securities | 30,016 | 45,000 | - | - | - | **75,016** |
| Loans | 155,345 | 235,443 | 393,253 | 93,081 | - | **877,122** |
| Equity investments | - | - | - | - | 84,860 | **84,860** |
| Other assets | - | - | - | - | 10,799 | **10,799** |
| Total | 249,314 | 280,443 | 393,253 | 93,081 | 95,661 | **1,111,752** |
| **Liabilities** | | | | | | |
| Borrowings | - | 19,737 | 90,595 | 230,883 | - | **341,215** |
| Derivative financial instruments | - | - | - | - | 11,769 | **11,769** |
| Payables and accrued interest | - | - | - | - | 8,968 | **8,968** |
| Total | - | 19,737 | 90,595 | 230,883 | 20,737 | **361,952** |
| Derivative financial instruments | (172,584) | (750) | - | 173,334 | - | **-** |
| **Interest rate risk at 31 December 2014** | **76,730** | **259,956** | **302,658** | **35,532** | **74,924** | **749,800** |

| Presented in EUR (000) | Interest bearing: Up to 1 month | Interest bearing: From 1 month to 3 months | Interest bearing: From 3 months to 1 year | Interest bearing: From 1 year to 5 years | Non-interest bearing | **Total** |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Cash and bank balances | 14,847 | - | - | - | 2 | **14,849** |
| Debt investment securities | 125,000 | 21,502 | 11,310 | - | - | **157,812** |
| Derivative financial instruments | - | - | - | - | 16,210 | **16,210** |
| Loans | 147,744 | 223,095 | 275,136 | 80,430 | - | **726,405** |
| Equity investments | - | - | - | - | 52,934 | **52,934** |
| Other assets | - | - | - | - | 9,832 | **9,832** |
| Total | 287,591 | 244,597 | 286,446 | 80,430 | 78,978 | **978,042** |
| **Liabilities** | | | | | | |
| Borrowings | - | 9,000 | 107,569 | 169,775 | - | **286,344** |
| Payables and accrued interest | - | - | - | - | 4,761 | **4,761** |
| Total | - | 9,000 | 107,569 | 169,775 | 4,761 | **291,105** |
| Derivative financial instruments | (167,896) | (1,879) | - | 169,775 | - | **-** |
| **Interest rate risk at 31 December 2013** | **119,695** | **233,718** | **178,877** | **80,430** | **74,217** | **686,937** |

### c) Sensitivity analysis

The Bank's interest rate sensitivity analysis comprises 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 2014 | At 31 December 2013 |
|---|---|---|
| Euro | (75,300) | 104,700 |
| United states dollar | 207,500 | 152,700 |
| Total re-pricing gap | 132,200 | 257,400 |
| **Shift of 50 basis points in the EUR curve** | **661** | **1,287** |

## 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

### a) Classification

Investment securities classified as “available for sale” include government and corporate bonds and Euro Commercial Paper, and their fair value has been determined using quoted prices.

Equity investments classified as “available for sale” include investments in 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.

### b) Financial assets and liabilities

The tables below identify the Bank’s financial assets and financial liabilities in accordance with IAS 39 categories. The fair value of the financial assets and financial liabilities is disclosed as equal to the carrying value, plus accrued interest, as all bear a variable interest rate and are given at market terms and conditions.

| | At 31 December 2014 | | | |
|---|---|---|---|---|
| Presented in EUR (000) | Held-to-maturity | Loans and receivables | At amortized cost | **Carrying amount** |
| **Assets** | | | | |
| Cash and bank balances | - | - | 63,955 | **63,955** |
| Loans | - | 877,122 | - | **877,122** |
| Deferred income | - | - | (8,125) | **(8,125)** |
| Impairment losses on loans | - | (47,734) | - | **(47,734)** |
| Other assets | - | 10,799 | - | **10,799** |
| **Total financial assets** | **-** | **840,187** | **55,830** | **896,017** |
| **Liabilities** | | | | |
| Borrowings | - | - | 341,215 | **341,215** |
| Payables and accrued interest | - | - | 8,968 | **8,968** |
| **Total financial liabilities** | **-** | **-** | **350,183** | **350,183** |

| | At 31 December 2013 | | | |
|---|---|---|---|---|
| Presented in EUR (000) | Held-to-maturity | Loans and receivables | At amortized cost | **Carrying amount** |
| **Assets** | | | | |
| Cash and bank balances | - | - | 14,849 | **14,849** |
| Loans | - | 726,405 | - | **726,405** |
| Deferred income | - | - | (6,146) | **(6,146)** |
| Impairment losses on loans | - | (41,163) | - | **(41,163)** |
| Other assets | - | 9,832 | - | **9,832** |
| **Total financial assets** | **-** | **695,074** | **8,703** | **703,777** |
| **Liabilities** | | | | |
| Borrowings | - | - | 286,344 | **286,344** |
| Payables and accrued interest | - | - | 4,761 | **4,761** |
| **Total financial liabilities** | **-** | **-** | **291,105** | **291,105** |

### c) 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 | 75,016 | - | - | **75,016** |
| Equity investments | - | - | 84,860 | **84,860** |
| Derivative financial instruments | - | (11,769) | - | **(11,769)** |
| **At 31 December 2014** | **75,016** | **(11,769)** | **84,860** | **148,107** |

There have been no transfers between Level 1 and Level 2 during the year. For Level 1 and Level 2 the valuation techniques used are broker quotes and observable market data, or discounted cash flow models. For Level 3 the valuation technique used is the net asset value ("NAV").

| Presented in EUR (000) | Level 1 | Level 2 | Level 3 | Carrying amount |
|---|---|---|---|---|
| Available-for-sale: | | | | |
| Debt investment securities | 157,812 | - | - | **157,812** |
| Equity investments | - | - | 52,934 | **52,934** |
| Derivative financial instruments | - | 16,210 | - | **16,210** |
| **At 31 December 2013** | **157,812** | **16,210** | **52,934** | **226,956** |

### d) 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 2014 | At 31 December 2013 |
|---|---|---|
| At 1 January | 52,934 | 43,290 |
| Total gains or (losses) for the year recognized in the income statement | - | - |
| Total gains recognized in other comprehensive income | 24,828 | 5,091 |
| Purchases, sales, issues and settlements | 7,098 | 4,553 |
| Transfers into or out of level 3 | - | - |
| **At end of period** | **84,860** | **52,934** |

### e) Sensitivity analysis for level 3

The table below indicates a possible impact on net income for the Level 3 financial instruments carried at fair value at 31 December 2014, on an estimated 5% increase or decrease in net assets value of the equity investments, based on the Bank's participation.

| Presented in EUR (000) | Carrying amount | Favorable change | Unfavorable change |
|---|---|---|---|
| Equity investments | 84,860 | 4,243 | (4,243) |

## Capital Management

At the inception of the Bank, initial authorized share capital was SDR 1 billion, which was fully subscribed by the Member 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. The increase allows 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 Member 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.

Pursuant to Resolution 131 of the Board of Governors, a unanimously adopted first amendment to the Establishing Agreement became effective on 21 June 2013. As of this effective date, and as per Resolution 131 of the Board of Governors, the unit of account of the Bank became the EUR and all of the Bank's authorized share capital was redenominated from SDR to EUR. The conversion rate applied was SDR to EUR fixed at 1:1.15.

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 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. Operating Segments

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) | 31 December 2014 | | | 31 December 2013 | | |
|---|---|---|---|---|---|---|
| | Lending | Treasury | Total | Lending | Treasury | Total |
| **Income statement** | | | | | | |
| Interest income | 39,854 | 1,964 | 41,818 | 38,282 | 2,021 | 40,303 |
| Net fees and commissions | 634 | 1 | 635 | 538 | - | 538 |
| Other income (expense) | 2,242 | (177) | 2,065 | 1,223 | (47) | 1,176 |
| Total segment revenues | 42,730 | 1,788 | 44,518 | 40,043 | 1,974 | 42,017 |
| Less: interest expense | (9,117) | (2,588) | (11,705) | (10,121) | (2,374) | (12,495) |
| Net fair value and foreign exchange | - | (95) | (95) | - | (748) | (748) |
| Less: personnel and other admin. expenses | (15,614) | (913) | (16,527) | (15,251) | (1,008) | (16,259) |
| Less: depreciation and amortization | (757) | (8) | (765) | (654) | (6) | (660) |
| Segment income before impairment | 17,242 | (1,816) | 15,426 | 14,017 | (2,162) | 11,855 |
| Less: impairment (losses) release | (1,403) | - | (1,403) | (675) | 2,104 | 1,429 |
| **Net income for the year** | **15,839** | **(1,816)** | **14,023** | **13,342** | **(58)** | **13,284** |

| Presented in EUR (000) | 31 December 2014 | | | 31 December 2013 | | |
|---|---|---|---|---|---|---|
| | Lending | Treasury | Total | Lending | Treasury | Total |
| **Financial position** | | | | | | |
| Segment assets | 918,092 | 138,971 | 1,057,063 | 743,327 | 188,871 | 932,198 |
| **At end of year** | | | **1,057,063** | | | **932,198** |
| Segment liabilities | 350,183 | 11,769 | 361,952 | 291,105 | - | 291,105 |
| Members' equity | - | - | 695,111 | - | - | 641,093 |
| **At end of year** | | | **1,057,063** | | | **932,198** |

The geographical segment reporting of the Bank is presented in note 16 "Operational analysis".

# 7. Interest Income

Interest and similar income is analyzed as follows:

| Presented in EUR (000) | Year to 31 December 2014 | Year to 31 December 2013 |
|---|---|---|
| From loans and advances | 39,854 | 38,282 |
| From placements with financial institutions | 1 | 2 |
| From investment securities available-for-sale | 1,086 | 791 |
| From investment securities held-to-maturity | - | 583 |
| From derivative financial assets at fair value | 877 | 645 |
| **Interest income** | **41,818** | **40,303** |

# 8. Interest Expense

Interest and similar expense is analyzed as follows:

| Presented in EUR (000) | Year to 31 December 2014 | Year to 31 December 2013 |
|---|---|---|
| From borrowed funds | 3,850 | 4,517 |
| From issued debt | 4,574 | 4,475 |
| From derivative financial liabilities at fair value | 2,483 | 2,287 |
| From amortized issuance and arrangement costs | 693 | 1,129 |
| From other charges | 105 | 87 |
| **Interest expense** | **11,705** | **12,495** |

# 9. Net Fees and Commissions

Net fees and commissions is analyzed as follows:

| Presented in EUR (000) | Year to 31 December 2014 | Year to 31 December 2013 |
|---|---|---|
| Guarantee fees | 41 | 27 |
| Management fees | 272 | 173 |
| Appraisal fees | 33 | 36 |
| Administration fees | 12 | 15 |
| Arrangement fees | - | 51 |
| Surveillance fees | 67 | 19 |
| Prepayment / cancellation fees | 198 | 204 |
| Other fees | 12 | 13 |
| **Net Fees and commissions** | **635** | **538** |

# 10. Personnel and Other Administrative Expenses

Administrative expenses are analyzed as follows:

| Presented in EUR (000) | Year to 31 December 2014 | Year to 31 December 2013 |
|---|---|---|
| Salaries and benefits | 10,828 | 10,294 |
| Staff retirement plans | 2,246 | 2,380 |
| **Personnel expenses** | **13,074** | **12,674** |

| | | |
|---|---|---|
| Professional fees and related expenses | 573 | 707 |
| Utilities and maintenance | 1,350 | 1,390 |
| Other administrative | 1,530 | 1,488 |
| **Other administrative expenses** | **3,453** | **3,585** |

The average number of staff employed during the year was 103 (2013: 104). The number of staff at 31 December 2014 was 103 (2013: 103). Further analysis of the staff retirement plan is presented in note “Employee benefits”.

# 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 2012 | 8,824 | 33,202 | 42,026 |
| Charge for the year | 2,589 | - | 2,589 |
| Release for the year | (1,924) | - | (1,924) |
| Foreign exchange adjustments | (186) | (1,342) | (1,528) |
| At 31 December 2013 | 9,303 | 31,860 | 41,163 |
| Charge for the year | 2,217 | 6,336 | 8,553 |
| Release for the year | (4,941) | (2,206) | (7,147) |
| Foreign exchange adjustments | 368 | 4,797 | 5,165 |
| **At 31 December 2014** | **6,947** | **40,787** | **47,734** |

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 2014 the Bank categorized five loans as impaired with an exposure amount of EUR 59,897 thousand (2013: EUR 68,061 thousand) and the provision on these assets amounted to EUR 40,787 thousand (2013: EUR 31,860 thousand). Management estimates that the allowance for the impaired loans is adequate to cover potential or unforeseen uncollectible amounts in the existing portfolio.

# 12. Debt Investment Securities

Debt investment securities are analyzed as follows:

| Presented in EUR (000) | At 31 December 2014 | At 31 December 2013 |
|---|---|---|
| Government bonds | - | 1,502 |
| Corporate bonds | 10,016 | 11,310 |
| Commercial papers | 65,000 | 145,000 |
| **Debt investment securities** | **75,016** | **157,812** |

# 13. Derivative Financial Instruments, Net

The table below shows the Bank's outstanding forward foreign exchange contracts. The first column shows the sum of notional amounts, which is the amount of a derivative's nominal value and is the basis upon which changes in the value are measured. The second column shows the market value of the notional amounts and also the net valuation attributable to fair value hedges.

| | At 31 December 2014 | | At 31 December 2013 | |
|---|---|---|---|---|
| Presented in EUR (000) | Notional amount | Fair value | Notional amount | Fair value |
| Currency swap purchases | 110,000 | 110,000 | 123,396 | 123,396 |
| Currency swap sales | (112,440) | (112,578) | (121,849) | (121,793) |
| Designated as fair value hedges | - | (9,191) | - | 14,607 |
| **Derivative financial instruments** | **(2,440)** | **(11,769)** | **1,547** | **16,210** |

The above derivative financial instrument contracts with financial counterparties have been documented under International Swaps and Derivative Association ("ISDA") Master Agreements with Credit Support Annexes ("CSA"s). Pursuant to such arrangements, the Bank is eligible to offset assets and liabilities in the event of a counterparty default occurrence.

The Bank's hedge accounting is based on a clearly documented relationship between the item hedged and the hedging instrument, having a one-on-one relationship, which is documented at the time a hedge transaction is entered into. This relationship arises within the context of the Bank's borrowing activities in which the Bank's issued bonds are combined with swaps to achieve floating-rate debt in a currency sought by the Bank.

# 14. 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 2014 | At 31 December 2013 |
|---|---|---|
| At 1 January | 726,405 | 742,614 |
| Disbursements | 283,147 | 193,085 |
| Less: repayments | (180,720) | (188,821) |
| Foreign exchange movements | 48,290 | (20,473) |
| Loans total | 877,122 | 726,405 |
| Less: deferred income | (8,125) | (6,146) |
| Less: impairment losses | (47,734) | (41,163) |
| **Loans net of impairment** | **821,263** | **679,096** |

As of 31 December 2014 all loan facilities are classified as standard apart from four that were impaired. As of this date, the amount of interest and similar income that has not been accrued related to impaired loans was EUR 12,163 thousand, out of which an amount of EUR 3,427 thousand refers to the current year.

At 31 December 2014 the Bank had no restructured loan operation for the reporting period.

| Presented in EUR (000) | At 31 December 2014 | At 31 December 2013 |
|---|---|---|
| Collectively impaired | 817,225 | 658,344 |
| Less: deferred income | (8,125) | (6,146) |
| Less: allowance for impairment | (6,947) | (9,303) |
| Carrying amount | 802,153 | 642,895 |
| Individually impaired | 59,897 | 68,061 |
| Less: allowance for impairment | (40,787) | (31,860) |
| Carrying amount | 19,110 | 36,201 |
| Past due but not impaired | - | - |
| **Total carrying amount at amortized cost** | **821,263** | **679,096** |

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".

# 15. 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.

| | | At 31 December 2014 | | At 31 December 2013 | |
|---|---|---|---|---|---|
| Presented in EUR (000) | % of Investment | Cost | Fair value | Cost | Fair value |
| SEAF Caucasus Growth Fund | 21.39 | 6,344 | 4,606 | 4,529 | 4,012 |
| Access Bank, Azerbaijan | 20.00 | 17,945 | 45,237 | 15,792 | 21,197 |
| Balkan Accession Fund | 9.09 | 7,582 | 7,392 | 7,663 | 6,583 |
| A-Park Kaluga, Russia | 19.99 | 1,714 | 1,018 | 1,714 | 2,951 |
| Emerging Europe Accession Fund | 10.15 | 3,100 | 2,443 | 2,109 | 1,716 |
| Rusal | 0.01 | 4 | 235 | 4 | 92 |
| ADM Ceecat Recovery Fund | 5.65 | 11,194 | 11,085 | 10,036 | 9,913 |
| European Virgin Fund | 21.05 | 7,149 | 7,126 | 5,996 | 6,470 |
| Teamnet International | 6.90 | 5,000 | 5,718 | - | - |
| Natfood | 0.01 | - | - | - | - |
| **Equity investments available-for-sale** | | **60,032** | **84,860** | **47,843** | **52,934** |

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 2014, as management considers that is the best available estimate of the investments fair value. The techniques applied to perform these valuations include equity calculations based on EBITDA and market data.

The increase of EUR 24,828 thousand corresponds to the difference between acquisition cost and fair value as of 31 December 2014.

During the year the Bank had realized a dividend income of EUR 1,690 thousand from its investment in the Access Bank and A-Park Kaluga.

As of 31 December 2014 the Bank has a committed amount of EUR 11,975 thousand towards the above entities participation. Further analysis of the equity investment portfolio is presented in note "Operational analysis".

As at 31 December 2014 the Bank has 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.

# 16. Operational Analysis

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

| | At 31 December 2014 | | At 31 December 2013 | |
|---|---|---|---|---|
| Presented in EUR (000) | Outstanding disbursements | Undrawn commitments | Outstanding disbursements | Undrawn commitments |
| Analysis by instrument | | | | |
| Loans | 877,122 | 62,885 | 726,405 | 116,251 |
| Equity investments | 84,860 | 11,975 | 52,934 | 15,895 |
| Guarantees | - | 16,000 | - | 16,000 |
| **At end of year** | **961,982** | **90,860** | **779,339** | **148,146** |
| Analysis by country | | | | |
| Albania | 29,631 | 2,039 | 17,576 | 18,860 |
| Armenia | 65,929 | 2,292 | 35,238 | 5,377 |
| Azerbaijan | 141,914 | 9,423 | 92,046 | 18,235 |
| Bulgaria | 57,853 | 1,092 | 61,702 | 1,500 |
| Georgia | 12,106 | 30,018 | 14,160 | 25,379 |
| Greece | 45,951 | - | 36,841 | - |
| Moldova | 16,444 | 2,047 | 18,146 | 2,573 |
| Romania | 120,532 | 1,391 | 47,406 | 12,406 |
| Russia | 227,275 | 592 | 182,669 | 15,435 |
| Turkey | 172,138 | 3,989 | 204,098 | 10,200 |
| Ukraine | 72,209 | 37,977 | 69,457 | 38,181 |
| **At end of year** | **961,982** | **90,860** | **779,339** | **148,146** |
| Loans analysis by sector | | | | |
| Consumer discretionary | 47,208 | 12,515 | 32,994 | - |
| Consumer staples | 98,745 | - | 71,025 | 8,920 |
| Energy | 2,595 | 24,710 | 3,190 | 35,349 |
| Financial institutions | 434,985 | 24,302 | 349,623 | 42,239 |
| Health care | 9,120 | - | 9,074 | - |
| Industrials | 118,118 | - | 134,338 | 11,743 |
| Information technology | 7,500 | - | - | - |
| Materials | 77,348 | 1,358 | 56,696 | 18,000 |
| Real estate | 29,372 | - | 32,383 | - |
| Telecom services | - | - | - | - |
| Utilities | 52,131 | - | 37,082 | - |
| **At end of year** | **877,122** | **62,885** | **726,405** | **116,251** |

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

# 17. Property and Equipment

Property and equipment are analyzed as follows:

| Presented in EUR (000) | Buildings (leasehold) | Vehicle | Furniture and office accessories | Computers and office equipment | Total |
|---|---|---|---|---|---|
| Cost | | | | | |
| At 31 December 2012 | 337 | 95 | 610 | 1,888 | 2,930 |
| Additions | 195 | - | 6 | 245 | 446 |
| Disposals | (1) | - | (59) | (695) | (755) |
| At 31 December 2013 | 531 | 95 | 557 | 1,438 | 2,621 |
| Additions | 203 | - | 41 | 142 | 386 |
| Disposals | - | - | (30) | (120) | (150) |
| **At 3 December 2014** | **734** | **95** | **568** | **1,460** | **2,857** |
| Accumulated depreciation | | | | | |
| At 31 December 2012 | 204 | 33 | 504 | 1,490 | 2,231 |
| Charges | 79 | 19 | 29 | 213 | 340 |
| Disposals | (1) | - | (59) | (695) | (755) |
| At 31 December 2013 | 282 | 52 | 474 | 1,008 | 1,816 |
| Charges | 163 | 19 | 37 | 216 | 435 |
| Disposals | - | - | (30) | (120) | (150) |
| **At 31 December 2014** | **445** | **71** | **481** | **1,104** | **2,101** |
| Net book value | | | | | |
| **At 31 December 2014** | **289** | **24** | **87** | **356** | **756** |
| At 31 December 2013 | 249 | 43 | 83 | 430 | 805 |
| At 31 December 2012 | 133 | 62 | 106 | 398 | 699 |

# 18. Intangible Assets

Intangible assets comprising computer software are analyzed as follows:

| Presented in EUR (000) | Total |
|---|---|
| Cost | |
| At 31 December 2012 | 3,184 |
| Additions | 163 |
| At 31 December 2013 | 3,347 |
| Additions | 84 |
| **At 31 December 2014** | **3,431** |
| Accumulated amortization | |
| At 31 December 2012 | 2,368 |
| Charges | 319 |
| At 31 December 2013 | 2,687 |
| Charges | 330 |
| **At 31 December 2014** | **3,017** |
| Net book value | |
| **At 31 December 2014** | **414** |
| At 31 December 2013 | 660 |
| At 31 December 2012 | 816 |

# 19. Other Assets

Other assets are analyzed as follows:

| Presented in EUR (000) | At 31 December 2014 | At 31 December 2013 |
|---|---|---|
| Accrued interest | 8,050 | 7,061 |
| Advances and prepaid expenses | 1,973 | 2,526 |
| Other prepayments | 184 | 175 |
| Guarantee deposits | 592 | 70 |
| **Other assets** | **10,799** | **9,832** |

# 20. Borrowings

Borrowing facilities arranged at the financial position date are analyzed below. In addition to medium or long-term borrowings, the Bank utilizes short-term financing in the form of ECP issuance or borrowings from commercial banks for cash management purposes. At 31 December 2014 the Bank had issued debt securities in the amount of EUR 178,227 thousand.

| Presented in EUR (000) | At 31 December 2014 | | At 31 December 2013 | |
|---|---|---|---|---|
| | Amount used | Borrowings arranged | Amount used | Borrowings arranged |
| Euro | 91,865 | 121,865 | 86,278 | 146,278 |
| United States dollar | 83,071 | 83,071 | 37,291 | 88,049 |
| Swiss franc | 166,279 | 166,279 | 162,775 | 162,775 |
| **Total** | **341,215** | **371,215** | **286,344** | **397,102** |

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.

# 21. Payables and Accrued Interest

Payables and accrued interest are analyzed as follows:

| Presented in EUR (000) | At 31 December 2014 | At 31 December 2013 |
|---|---|---|
| Accrued interest | 3,572 | 3,703 |
| Social insurance fund (IKA) contributions | 5 | 16 |
| Pension plan obligation | 4,664 | 121 |
| Suppliers and other accrued expenses | 716 | 907 |
| Other | 11 | 14 |
| **Payables and accrued interest** | **8,968** | **4,761** |

# 22. Share Capital

From the Bank's inception, and in accordance with Article 4 of the Establishing Agreement, the Bank denominated its authorized share capital in the Special Drawing Right ("SDR"), as defined by the International Monetary Fund ("IMF"). Resolution 131 of the Board of Governors ("BoG") unanimously adopted the requisite amendments to paragraph 1 of Article 4 and Articles 23 and 24 of the Establishing Agreement, to expressly include, among the exclusive powers of the BoG, the change of the unit of account of the Bank and the redenomination of all capital stock of the Bank. These amendments to the Establishing Agreement became effective on 21 June 2013 (the "Effective Date"). In accordance with such Resolution 131 of the Board of Governors, as of the Effective Date, the unit of account of the Bank became the EUR and the authorized capital stock of the Bank was redenominated into three billion four hundred and fifty million EUR (3,450,000,000), divided into three million (3,000,000) shares having a par value of one thousand and one hundred and fifty EUR (1,150) each, inclusive of all subscribed and unallocated shares. Accordingly, as of the Effective Date, all outstanding share capital commitments of participating members, in respect of their subscribed shares, were converted into EUR.

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 (fully paid and payable in installments) and callable shares. Payment for the paid-in shares subscribed to by members was made over a period of years in accordance with Article 6 of the Establishing Agreement for the initial capital raising purpose of the Bank, and as determined in advance by the Bank for capital increases (in the only capital increase of the Bank so far, the structure of payments specified was similar to the one in Article 6). The same Article states that payment of the amount subscribed to, in respect of 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 a notice 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 will 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; the Board of Governors approved their request. On 5 October 2008 the new shares pursuant to the capital increase of the Bank were offered in the same structure as the initial authorized share capital, in the amount of EUR 1.150 billion, and were fully subscribed by the Member States. Furthermore, Azerbaijan also subscribed to the 3% of the initial authorized share capital that remained unallocated, after the above mentioned participation reduction, while Romania subscribed both to their allocation of new shares and to those that would have been allocated to Georgia, had it chosen to participate in the capital increase. This subscription process followed a decision taken by the Board of Governors in December 2007 to triple the Bank's authorized capital to EUR 3.450 billion and to double the subscribed capital to EUR 2.3 billion, while leaving authorized capital of EUR 1.150 billion unallocated. On October 2011 the Board of Governors approved Moldova's request for a fifty per cent reduction of its portion of subscribed capital, from 1% to 0.5%, and those shares were released to unallocated share capital.

The above share capital is analyzed as follows:

| Presented in EUR (000) | At 31 December 2014 | At 31 December 2013 |
|---|---|---|
| Authorized share capital | 3,450,000 | 3,450,000 |
| Less: unallocated share capital* | (1,161,500) | (1,161,500) |
| Subscribed share capital | 2,288,500 | 2,288,500 |
| Less: shares not yet called | (1,601,950) | (1,601,950) |
| Less: shares payable but not yet due | (131,675) | (155,695) |
| Less: shares payments past due | (12,027) | (12,889) |
| Paid-up share capital | 542,848 | 517,966 |
| Advance against future call | - | 5 |
| **Paid-in share capital** | **542,848** | **517,971** |

* Shares available to new or existing Member States.

## 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% (EUR 115 million) fully paid and 20% (EUR 230 million) payable by promissory notes or other obligations, which were not negotiable and non-interest bearing in eight equal successive annual installments in the years 1998-2005.

## Capital Increase

The capital increase of EUR 1.150 billion is divided into EUR 345 million paid in capital and EUR 805 million callable capital. Pursuant to the Board of Governors decision in October 2008, the EUR 345 million paid in portion is divided into 10% (EUR 115 million) fully paid shares in 2010 and 20% (EUR 230 million) payable shares by promissory notes or other obligation issued by members in eight equal successive annual installments in the years 2011 to 2018. As of October 2011, the capital increase was reduced by EUR 11.5 million of the subscribed share capital, due to an approved reduction by the Board of Governors in participation by Moldova.

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

| | At 31 December 2014 | | |
|---|---|---|---|
| Presented in EUR (000) | Initial capital | Capital increase | **Total** |
| Authorized share capital | 1,150,000 | 2,300,000 | **3,450,000** |
| Less: unallocated share capital | (34,500) | (1,127,000) | **(1,161,500)** |
| Subscribed share capital | 1,115,500 | 1,173,000 | **2,288,500** |
| Less: shares not yet called | (780,850) | (821,100) | **(1,601,950)** |
| Less: shares payable but not yet due | - | (131,675) | **(131,675)** |
| Less: shares payments past due | - | (12,027) | **(12,027)** |
| Paid-up share capital | 334,650 | 208,198 | **542,848** |
| Advance against future call | 40 | (40) | **0** |
| **Paid-in share capital** | **334,690** | **208,158** | **542,848** |

## 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 2014 is analyzed as follows:

| | | Subscribed | Callable | Payable | Paid |
|---|---|---|---|---|---|
| Member | Shares | Presented in EUR (000) | | | |
| Albania | 40,000 | 46,000 | 32,200 | 6,347 | 7,453 |
| Armenia | 20,000 | 23,000 | 16,100 | 1,150 | 5,750 |
| Azerbaijan | 100,000 | 115,000 | 80,500 | 5,750 | 28,750 |
| Bulgaria | 270,000 | 310,500 | 217,350 | 15,525 | 77,625 |
| Georgia | 10,000 | 11,500 | 8,050 | - | 3,450 |
| Greece | 330,000 | 379,500 | 265,650 | 18,975 | 94,875 |
| Moldova | 10,000 | 11,500 | 8,050 | - | 3,450 |
| Romania | 280,000 | 322,000 | 225,400 | 16,674 | 79,926 |
| Russian Fed. | 330,000 | 379,500 | 265,650 | 18,975 | 94,875 |
| Turkey | 330,000 | 379,500 | 265,650 | 18,975 | 94,875 |
| Ukraine | 270,000 | 310,500 | 217,350 | 41,331 | 51,819 |
| **Total** | **1,990,000** | **2,288,500** | **1,601,950** | **143,702** | **542,848** |

# 23. Reserves

Reserves are analyzed as follows:

| Presented in EUR (000) | General | Available-for-sale | Other | Total |
|---|---|---|---|---|
| At 31 December 2012 | 40,293 | 3,913 | (2,304) | 41,902 |
| Gains on revaluation of available-for-sale | - | 1,429 | - | 1,429 |
| Remeasurements of defined benefit scheme | - | - | 331 | 331 |
| Exchange rate difference due to conversion | - | - | 3,587 | 3,587 |
| Transferred from retained earnings | 3,270 | - | - | 3,270 |
| At 31 December 2013 | 43,563 | 5,342 | 1,614 | 50,519 |
| Gains on revaluation of available-for-sale | - | 19,500 | - | 19,500 |
| Remeasurements of defined benefit scheme | - | - | (4,318) | (4,318) |
| Transferred from retained earnings | 5,688 | - | - | 5,688 |
| **At 31 December 2014** | **49,251** | **24,842** | **(2,704)** | **71,389** |

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.

# 24. Cash and Cash Equivalents

Cash and cash equivalents are analyzed as follows:

| Presented in EUR (000) | At 31 December 2014 | At 31 December 2013 |
|---|---|---|
| Cash on hand | 2 | 2 |
| | | |
| Investments maturing up to 1 month: | | |
| Bank balances | 63,953 | 14,847 |
| Available-for-sale portfolio | 20,000 | 125,000 |
| Investment maturing from 1 month to 3 months: | | |
| Available-for-sale portfolio | 45,000 | 20,000 |
| **Cash and cash equivalents** | **128,955** | **159,849** |

The commercial papers held in the Bank's portfolio and issued by other financial institutions were short term rated at a minimum of A2 by Standard and Poor's or P2 by Moody's, in accordance with internal financial policies.

# 25. Employee Benefits

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 2014. 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 2014 | At 31 December 2013 |
|---|---|---|
| Amounts recognized in the statement of financial position | | |
| Present value of the defined benefit obligations | 20,321 | 13,879 |
| Fair value of plan assets | (15,657) | (13,758) |
| **Net liability at end of the year** | **4,664** | **121** |
| Amounts recognized in the income statement | | |
| Service cost | 1,323 | 1,258 |
| Net interest on the net defined benefit liability/(asset) | (75) | 97 |
| Administration expense | 54 | 51 |
| **Total included in personnel expenses** | **1,302** | **1,406** |
| Remeasurements recognized in other comprehensive income | | |
| At 31 December | (1,973) | (2,304) |
| Liability gain (loss) due to changes in assumptions | (5,624) | 443 |
| Liability experiences gain (loss) arising during the year | 294 | (284) |
| Return on plan assets excluding income statement amounts | 1,012 | 172 |
| Total amount recognized during the year | (4,318) | 331 |
| **Cumulative in other comprehensive income (expense)** | **(6,291)** | **(1,973)** |
| Principal actuarial assumptions used | | |
| Discount rate | 2.30% | 4.00% |
| Expected return on plan assets | 2.30% | 4.00% |
| Future salary increase | 2.00% | 2.50% |
| Future pension increase | 2.00% | 2.00% |
| Average remaining working life of employees | 13 years | 14 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. at 2.30% pa.

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

| Presented in EUR (000) | At 31 December 2014 | At 31 December 2013 |
|---|---|---|
| Major categories of plan assets | | |
| Cash instruments | 5% | 10% |
| Fixed interest | 52% | 62% |
| Equities | 38% | 25% |
| Other | 5% | 3% |
| Reconciliation of plan assets | | |
| Market value at 1 January | 13,758 | 9,382 |
| Expected return | 629 | 380 |
| Contributions paid | 1,077 | 3,952 |
| Benefit pensions and lump sum paid to pensioners | (765) | (77) |
| Expenses | (54) | (51) |
| Asset gain (loss) | 1,012 | 172 |
| **Fair value of plan assets** | **15,657** | **13,758** |

The actual investment return on assets of the Fund was 12.5%. 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 estimate of contributions to be paid in 2015 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) | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| Defined benefit obligations | 20,321 | 13,879 | 12,381 | 7,935 | 7,095 |
| Plan assets | (15,657) | (13,758) | (9,382) | (7,788) | (6,860) |
| Plan deficit (surplus) | 4,664 | 121 | 2,999 | 147 | 235 |
| **Net experience adjustments on plan liabilities (assets)** | **5,624** | **(443)** | **2,706** | **(809)** | **177** |

## Defined Contribution Scheme

The pension expense under this scheme was EUR 895 thousand (2013: EUR 883 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 49 thousand (2013: EUR 91 thousand) and is included in “Personnel expense”.

# 26. 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 period included in “Other administrative expenses” totaled EUR 699 thousand (2013: EUR 781 thousand).

# 27. 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 period were EUR 1,480 thousand (2013: EUR 1,203 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 2014, the Bank administered two special funds. Extracts from the audited financial statements are included under the "Summary of special funds".

# 28. Events After the Reporting Period

In January 2015, Albania paid an amount of EUR 1,177 thousand, fully discharging its obligations for the year 2014.

# 29. 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 2014 | At 31 December 2013 |
|---|---|---|
| Statement of movements | | |
| Balance brought forward | 223 | 291 |
| Net income for the year | - | - |
| Less: disbursements | (141) | (68) |
| **Balance of available funds** | **82** | **223** |
| Financial position | | |
| Placements with other financial institutions | 82 | 223 |
| **Total Assets** | **82** | **223** |
| Unallocated fund balance | 82 | 223 |
| **Total Liabilities and Contributor Resources** | **82** | **223** |

## 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 2014 | At 31 December 2013 |
|---|---|---|
| Statement of movements | | |
| Balance brought forward | 318 | 318 |
| Net (loss) income for the year | (1) | - |
| Less: disbursements | (70) | - |
| **Balance of available funds** | **247** | **318** |
| Financial position | | |
| Placements with other financial institutions | 247 | 318 |
| **Total Assets** | **247** | **318** |
| Unallocated fund balance | 247 | 318 |
| **Total Liabilities and Contributor Resources** | **247** | **318** |

# 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 2014, 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 to 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.

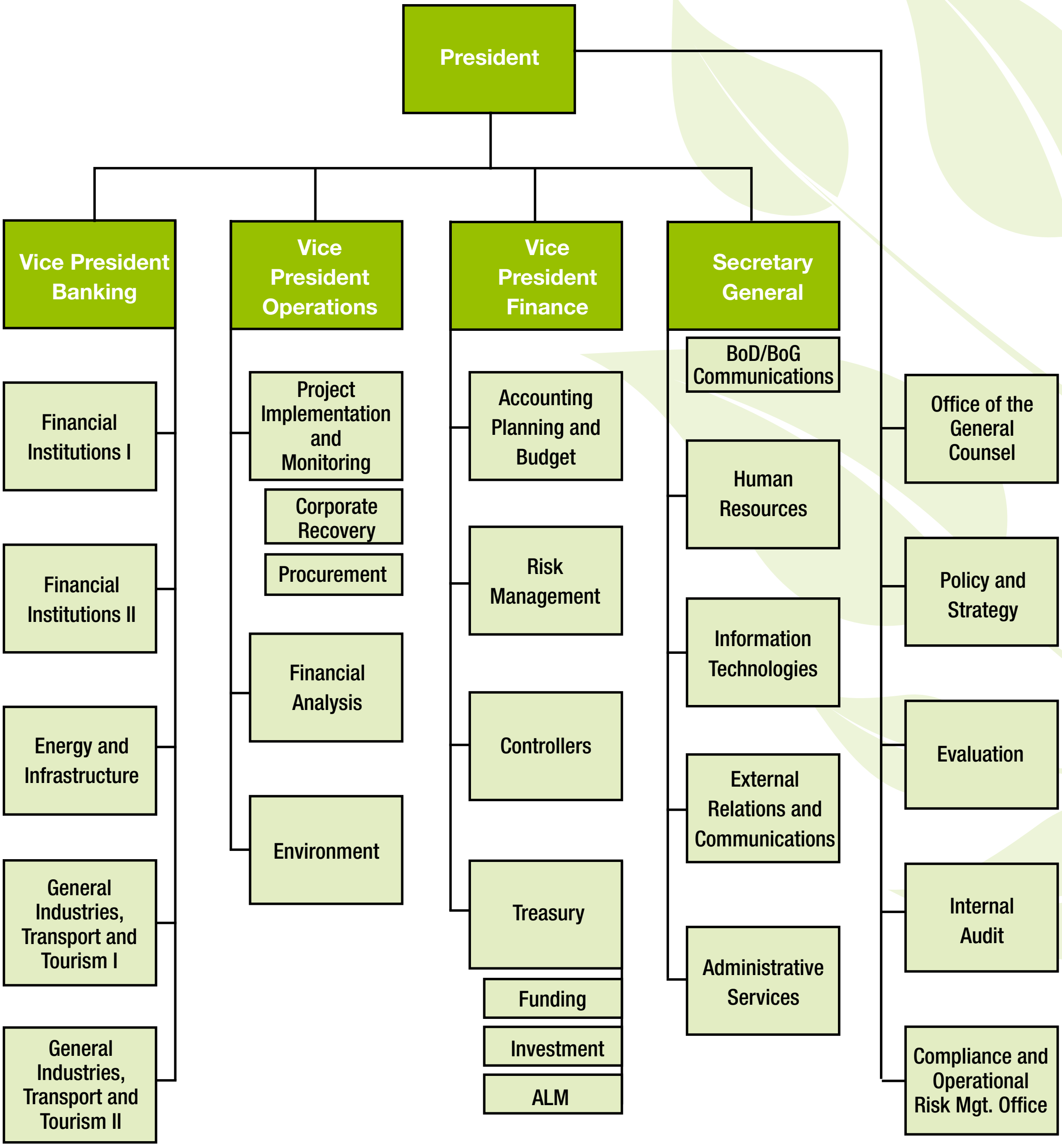
### Opinion

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 2014 and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

24 April 2015
**KPMG Certified Auditors A.E.**
**Athens, Greece**

Annex A

# Organizational Chart




As of 31 December 2014

Annex B

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