BLACK SEA TRADE AND DEVELOPMENT BANK

MEDIUM-TERM STRATEGY

AND

BUSINESS PLAN

2019-2022

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EXECUTIVE SUMMARY

The forthcoming period of the four year Medium Term Strategy and Business Plan (MTSBP) 2019-22, will represent a significant juncture for the Black Sea Trade and Development Bank as it seeks to build upon its track record of strong credibility to achieving a higher degree of relevance for its shareholders and the agencies, firms and banks active in the greater Black Sea Region:

- The MTSBP 2019-22 is the last one covering the period of the Long-term Strategic Framework (LTSF) 2010-20, and will be the first to open the new LTSF 2021-30.
- The MTSBP 2019-22 possesses a “point of inflection” aspect, moving from a strategy focused on “Consolidation” to a strategy focused on “Growth”, which also shifts the emphasis of the Mid-term review from implementation of LTSF 2010-20 to formulation of the new LTSF 2021-30.

Since initiating operations in 1999, the Black Sea Trade and Development Bank has established a strong financial profile- e.g. conservative independent policies; strong capitalization; high liquidity; prudent approach to borrowing, provisioning and investing- which forms the foundation for BSTDB’s credibility. While it has succeeded in this respect, and while the Bank’s credibility was and remains a fundamental foundation for being able to operate as a regional development institution, the Bank remains a small institution whose impact is limited. Put differently, the Bank’s business profile is rather moderate, with still limited contribution to the financing of overall development needs and promotion of cooperation in its countries of operation.

At its core, the current strategy involves maintaining the financial profile and enhancing the business profile. To this end, the Bank shall adjust its business model and seek to achieve a stronger business profile through faster operational growth, in order to facilitate achievement of its operational strategic goals.

The primary goal of BSTDB over the new Medium-term Strategy period is to achieve higher development and regional cooperation impact, while speeding up expansion of its portfolio, under its Base Case Scenario of Growth to achieve a portfolio of €2.1 billion outstanding and €2.3 - €2.4 billion signed operations by end 2022. This would represent average annual portfolio growth of around 12%, greater than the 8.7% average annual growth achieved over the course of the last decade.

The Bank intends to achieve this growth primarily via the provision of financing for infrastructure development, which will entail increasing its cooperation with the public sector. This represents a change of direction relative to the majority of Bank financing since its inception, which has gone to private sector clients, largely because that is from where demand for Bank financing has come.

The rationale for this shift includes that the principal role of MDBs is to seek to finance operations with high development impact, and these are typically in the public sector; and the observed growth in the sophistication of the private sector in recent years across the Black Sea Region and the fact that financing private sector operations should be mainly the function of commercial banks and other private financiers- with whom BSTDB wishes to avoid competing as much as possible, preferring be complementary and to help fill gaps in the market.

For this shift to higher public sector lending to occur, development of infrastructure projects which form the core of much public investment will be the main priorities of the Bank’s growth strategy. Notwithstanding the shift in emphasis, private sector lending will remain a steady and important area of activity. The Bank will finance private infrastructure development as well, while it will continue to provide corporate financing, and SME lending through intermediaries. With respect to financing trade, the Bank will continue to provide various trade finance products through specialized banks and agencies. It will also seek to increase its capacity to offer trade finance products directly, subject to demand for its financing. Specific operational targets will vary among Member Countries, and will be enumerated in greater detail in country strategies which will contain a mix of quantitative and qualitative targets that seek to coincide with and support national development priorities.

Financially, BSTDB will consider ways to secure a level and structure of its financial resources that would allow it to remain effective and increase relevance. The achievement of long-term positive net income is essential to the Bank's financial sustainability and consistent positive net income levels allow for increases in reserves and thus shareholder funds. Nonetheless, achievement of high portfolio growth may require showing greater flexibility in pricing, in conformity with market trends for public sector operations, something which may result in small fluctuations in net income in the short-run.

For BSTDB to successfully finance development while preserving financial strength, a series of elements need to be addressed so that they reinforce each other: and improve the Bank's financial position:

(i) Reduce borrowing costs,
(ii) active liquidity portfolio management and cost efficiency in mobilizing short and long term market funding, and
(iii) appropriate control of administrative expenses, while securing the necessary capacity to achieve safely the ambitious strategy goal.

Thus, while cognizant that the proposed shift in priority operational activities entails an increase in the risk assumed by the Bank in its portfolio, BSTDB will maintain high capitalization and other financial ratios, so as to keep its financial profile extremely strong.

Organizationally, there are many areas where the Bank is well structured, operates smoothly and effectively. Nevertheless, the Bank shall critically assess its organization structure from a cost effectiveness and operational efficiency perspective, with a view to eliminating bottlenecks and/or duplication of tasks, streamlining activity, enhancing intra-departmental cooperation and promoting the common goal of fulfilling the mandate of the Bank by focusing on strategic long-term objectives and medium-term goals.

Institutionally, the Bank needs to develop capabilities for conducting ongoing policy dialogue with Member Countries and other stakeholders, and intends to expand further its relationship and cooperation with its Observers, other members of the family international financial institutions (IFIs), and more broadly with the global financial community insofar as it relates to the development of interest in, and enhancement of the profile of, the Black Sea Region. One important part of this is that the Bank will continue to explore and pursue available possibilities for attracting new shareholders from among BSEC Member States and internationally reputed IFIs.

The Bank operates in fluid market conditions, and in a period of wide-ranging changes that have the potential to affect the international financial system and economic relations, with implications for the manner in which it conducts business. While Regional macroeconomic conditions are by and large on a solid footing as a result of the financial prudence and fiscal discipline Member Countries have shown in the aftermath of the 2008 crisis, Global financial and/ or geopolitical conditions may change and deteriorate as a result of any number of potential shocks or shifts. These may alter investors' perceptions of risk in emerging markets for the worse, leading to a decline both in the desire to hold debt issued by, and to invest further in, emerging markets.

Such shifts may affect the ability of the Bank to access capital markets in an affordable and unfettered manner, and therefore would hamper its ability to implement the preferred Base Case Scenario of Growth. Thus, the Bank has also explored a 'Maintaining Trend' Scenario, in which the portfolio would grow at an annual average rate of 8.0% and would reach € 1.8 billion by end 2022, as well as a more extreme 'Fallback' Scenario, under which conditions might deteriorate, with credit markets becoming highly restrictive, and thus limiting average annual growth to 5% with the outstanding portfolio reaching €1.6 billion.

1 Introduction

The Black Sea Trade and Development Bank (BSTDB) has succeeded in about 20 years of operational activity to create an image and a "brand" name. Compared to its peer group it had fared better in a shorter period of time. BSTDB demonstrated an ability to adapt to the dynamics of both conditions and demands in countries of operation, and to the evolving nature of the international development finance architecture.

The forthcoming period of the four year Medium Term Strategy and Business Plan (MTSBP) 2019-22, will be a critical juncture for the Bank to move from credibility to relevance:

- The MTSBP 2019-22 is the last one covering the period of the Long-term Strategic Framework (LTSF) 2010-20, and will be the first to open the new LTSF 2021-30.
- The MTSBP 2019-22 possesses a "point of inflection" aspect, moving from a LTSF focused on 'Consolidation" to a new LTFS focused on "Growth", which also shifts the emphasis of the Mid-term review from implementation of LTFS 2010-2020 to formulation of the new LTFS 2021-2030.
- As "Consolidation" was the main strategic objective of the LTSF in the post-crisis period, the new LTSF may be formulated so as to take advantage and valorize the potential offered by a potential new "super-cycle of growth and development".

2 Mission, Vision, Values

BSTDB possesses the dual mandate to (i) promote regional economic cooperation among, and (ii) economic development in its Member States by financing private and public sector operations and undertaking activities which promote the Black Sea Region and create value for the shareholders.

Within this mandate, the vision for BSTDB stated in the Long-Term Strategic Framework 2010-2020: The Next Ten Years (LTSF) is:

> "By 2020, the BSTDB intends to be recognized globally, and by its shareholders in particular, as one of the prominent development finance institutions for the Black Sea region, providing well-focused development assistance and solutions. Thus, BSTDB would become a preferred partner in the region for clients, multilateral and bilateral donors and other partners in development."

This represents an ambitious vision for a new multilateral development bank (MDB), and its achievement remains a work in progress. BSTDB has achieved recognition and acknowledgement in a crowded field containing larger and better rated MDBs. Most importantly, it has established its credibility and viability, as underscored by its A2 (Moody's) and A- (S&P) credit rating, and overall positive results.

As stated in the LTSF 2010-2020, the core values that constitute the foundation of the Bank's institutional culture are moral integrity, professional competence, loyalty to the institution, commitment to the region, non-discrimination and respect for the opinion of others.

3 Operating Context (Global and Regional Overview and Prospects)

3.1 The Global Economic Environment

Global Economic Growth

Global growth for 2018–19 is projected at 3.7%, the same as its 2017 level. However, this expansion has become uneven and may have peaked in some major economies. Downside risks to global growth have risen in the past six months and the potential for upside has receded. In particular, since March 2018 there have been massive capital flows reversal out of emerging markets and a deceleration of world trade in response to trade tensions, possible "currency wars", and increased protectionism.

Developed Economies

Among advanced economies, growth disappointed in the euro area, while the US economy showed resilience, with the rate of economic growth higher than that in other developed economies, as the private sector benefited from the fiscal stimulus. Among advanced economies, the subdued outlook for potential growth reflects, to a large extent, slower labor force growth due to population aging, although labor productivity growth is expected to improve in the medium term.

Developing Economies and Emerging Markets

GDP growth in emerging and developing economies as a whole is projected to remain subdued relative to previous years, reaching 4.7% in 2019 and 2020. The outlook for the Europe and Central Asia region is moderately positive, with Russia expected to slightly inch-up but remain under2%, while Emerging Europe is anticipated to decelerate rapidly from 6% in 2017 to just 2% in 2019. Among emerging market and developing economies, prospects for many economies to close income gaps relative to advanced economies appear weaker than in the past. Emerging market and developing economies are projected to grow by less than advanced economies in per capita terms over 2018–23.

Trade and Investment Flows

In 2017 global trade and investment flows were at their highest since the 2010–11 and supported global economic growth. The expansion in investment is projected to ease in 2018 and 2019 compared with 2017, with a more notable decline in trade growth. Capital flows to emerging markets weakened considerably in 2018. Evidence suggests that nonresident portfolio flows turned negative in the second quarter of 2018, consistent with foreign exchange market pressures on several emerging market economies. Downside risks are high, as a negative shock could trigger a sudden deterioration of risk appetite, which in turn could lead to disruptive portfolio adjustments, further capital flows out from emerging markets, and lead to further US dollar appreciation, thus straining potentially vulnerable economies with high leverage, fixed exchange rates, and/ or balance sheet mismatches.

Global Financial Conditions and Credit Markets

The global economy remains vulnerable to a sudden tightening of financial conditions. Across many economies, government and corporate debt is substantially higher than before the global financial crisis. In some emerging markets, there are also concerns about rising contingent liabilities. Global financial conditions have tightened over the past six months. Long-term government bond yields have generally increased, and sovereign spreads have widened significantly, more in countries with larger external financing needs.

In the United States the Federal Reserve signaled two additional interest rate hikes in 2018 and three in 2019. In the EU, in June, the European Central Bank announced an extension of its asset purchase program through the end of the year, while indicating it would reduce monthly purchases from €30 billion/month to €15 billion/month in October. Financial tensions could also arise from regulatory actions. A rollback of post-crisis regulatory reform and oversight—both domestically and internationally—could encourage excessive risk taking.

Inflation and Monetary policy

At present, inflationary pressures are very low, while monetary policy stances are projected to diverge considerably among advanced economies. Core inflation remains below central banks' targets in most advanced economies. Core annual consumer price inflation has exceeded 2% in the United States, averaged slightly more than 2% in the United Kingdom, while it remains at about 1% in the euro area and 0.3% in Japan. The ECB committed to maintaining rates at current levels at least through the summer of 2019. In July 2018, the Bank of Japan modified its yield curve control policy to allow the benchmark 10-year yield to remain around a target of about zero percent, and introduced forward guidance on maintaining ultralow policy rates for an extended period of time. Among other advanced economies, the Bank of England raised its policy rate by 25 basis points in August. In the emerging market and developing economy group, core inflation remains contained, with few exceptions. Nevertheless, policy rates have generally increased since the spring.

Unemployment

Unemployment, and in particular youth unemployment, remains a serious challenge, particularly for the Eurozone. In the US unemployment is at historic lows, but labor force participation rate is also relatively low compared to the EU. This highlights systemic problems, likely to persist.

3.2 Projections for 2019-2022

Beyond 2018-19, global growth is projected to remain steady, reaching 3.7% in 2020, and weakening a bit to 3.6% by 2022–23, largely reflecting a moderation in economic growth rates in advanced economies. Medium-term prospects for investment growth are much weaker in advanced economies, with capital spending projected to slow considerably as growth declines toward its lower potential rate. These developments put into perspective not just how challenging it will be to create growth going forward, but also suggest that access to credit will be tight and much more expensive in the future. Overall, the world's largest developed and emerging economies continue to face structural challenges and policy constraints that hinder investment and productivity growth, making the medium-term outlook uncertain.

Sustained external imbalances in the world's key economies and policy actions that threaten to widen such imbalances pose risks to global stability. Escalating trade tensions and the potential shift away from a multilateral, rules-based trading system are key threats to the global outlook. The proliferation of trade actions and threats, and the ongoing renegotiations of major free trade agreements have created pervasive uncertainty about future trade costs. An intensification of trade tensions and the associated further rise in policy uncertainty could trigger financial market volatility, and slow down global investment and trade. Volatility, in particular in currency markets, is expected to remain high. Countermeasures by emerging market economies aimed at preventing massive capital outflows cannot thus be dismissed. The currency market volatility underscores a distinct possibility of a "currency war" of competitive devaluations, which would threaten the stability of the international monetary and trade system.

3.3 Balance of Risks

Risks are largely on the downside, and uncertainties for the world economy remain high. These include international spillovers from the expected monetary tightening by major developed economies, external and internal vulnerabilities of emerging economies, and the general problem of the unsustainability of public finances in the long run and the persisting sluggishness in the Eurozone. Of these, the most immediate risk stems from the US Federal Reserve's exit from the quantitative easing programs and stepped up monetary policy normalization, resulting in a steep increase in the yield curve, with negative spillover effects, something which could have a disproportionately negative impact on the global economy.

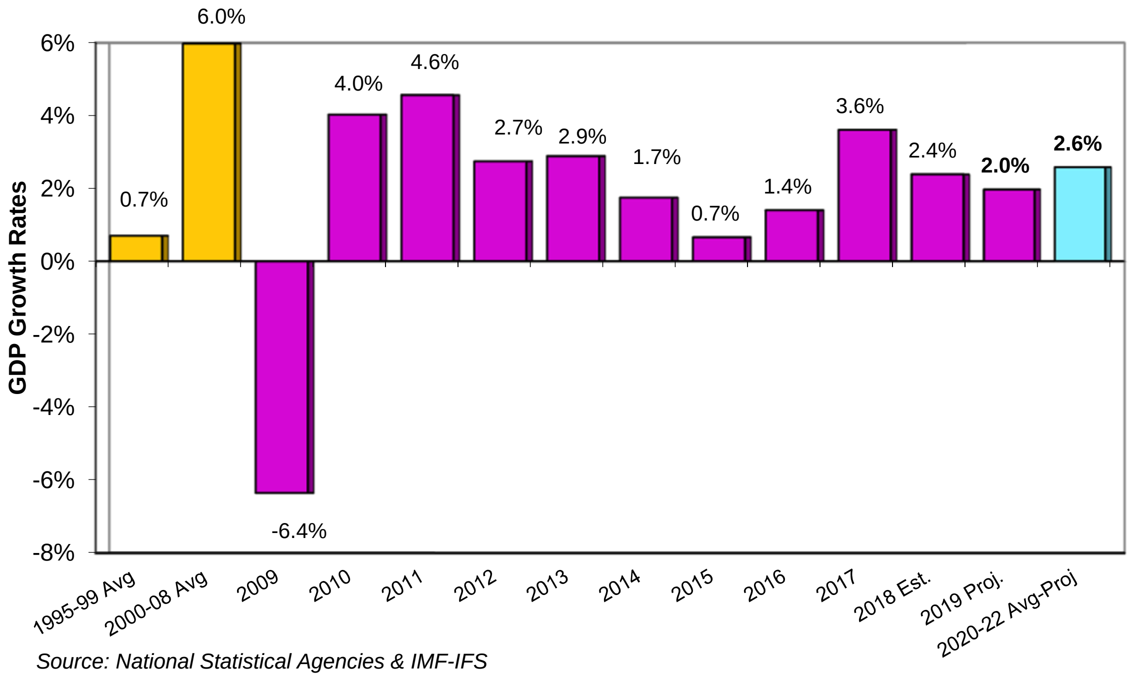
This creates major concerns for developing and emerging economies. There has been a slowdown in private capital flows to emerging markets, and volatility in these markets has increased with equity market sell-offs and local currency depreciation. These trends risk aggravating trade tensions and may result in a faster tightening of global financing conditions, with negative implications for emerging market economies, especially those with weak external positions. Over the medium term, widening debtor positions in key economies could constrain global growth and possibly result in sharp and disruptive currency and asset price adjustments.

Rising trade tensions and political and policy uncertainty could also lead to an abrupt reassessment of risks. In an environment of gradually tightening global interest rates and rising uncertainty, the likelihood of contagion from such episodes to other economies has also risen.

3.4 Economic Developments in the Black Sea Region

BSTDB implemented the MTSBP 2015-2018 in an economic environment characterized by high degrees of uncertainty and volatility across the Black Sea Region, but also noticeable improvement in performance by the end of the period. Real GDP grew at an average rate of 2.0% per annum, but this figure hides considerable fluctuation from one year to another and even greater variability in the economic performance of individual countries (See Figure 1).

Figure 1: GDP Growth in the Black Sea Region



Source: National Statistical Agencies & IMF-IFS

The Region began this period on a slowing trend, and 2015 represented the lowest point of five consecutive years of declining growth. The slowdown bottomed out with real GDP growth slipping to 0.7%, and a number of Member States experienced outright contractions. Subsequently, all the Region's economies recovered as a result of (i) their own solid macroeconomic management and (ii) the economic upturn in the European Union after several years of crisis, as the EU remains the Black Sea Region's largest economic partner for trade, investment and other financing.

Average real GDP growth rebounded to 1.4% in 2016 and accelerated to 3.6% in 2017, the highest level in six years. The growth continued into 2018, but rising geopolitical frictions and emerging market turmoil resulting from the increase in US dollar interest rates have dampened the momentum over the course of the year, with annual GDP growth expected to slip to around 2.5% or so.

The current cycle is considerably lower than the 6.0% real GDP growth averaged from 2000-08. However, that boom period led to increasing imbalances and overheating of economies, and ultimately resulted in the Region experiencing the sharpest downturn globally in 2009. By contrast, the current cycle is more broad-based, with all sectors of the economy contributing to the improving performance. On the demand side, exports have performed strongly the last two years and private consumption has been strong, while government consumption has declined as countries have prudently used the upturn to improve fiscal balances and reduce public debt levels. This trend is indicative of the careful attention that governments are paying to the health of key macroeconomic indicators. In addition to the government budget and public debt, current account levels have also improved, even in historically high deficit countries the levels have declined to manageable levels. Financial policies have similarly been successfully implemented. Notwithstanding devaluation and oil price fueled concerns in certain countries, inflation has trended downwards from 2015-18, and credit growth has been moderated- below 10% annually with the share of bad loans slowly but steadily declining in certain at risk economies.

The one big area of concern remains investment- both public and private. It is a critical component of current economic activity and a key sign of potential growth in coming years and confidence in future economic prospects. Investment is necessary for future growth, to expand infrastructure and the overall wealth generating capacity of an economy. Investment in the Black Sea Region has been disappointing in the post-crisis era, well short of the double digit levels averaged during the pre-crisis boom, and occasionally slipping into negative territory. One reason for the strong 2017 outturns was a reversal of three consecutive years of contraction in gross fixed investment, as it increased by 5.2%. But it may have been nothing more than a one off ‘bounce back’, as 2018 will likely be disappointing, with limited new investment growth.

Under-investment is one of the most important legacy effects of the 2008 financial crisis. Despite historically low interest rates, governments have been reluctant to borrow for two key reasons (i) the post crisis economic downturn left them with higher debt levels and a need to prioritize fiscal consolidation at the expense of investment, and (ii) concerns that markets might freeze up again, or more likely, interest rates and/ or spreads might suddenly jump leaving countries with a high stock of debt- often short term in nature- vulnerable to refinancing risk and possibly facing fiscally destabilizing higher costs. In the private sector, the picture is more mixed, as there exist instances of high corporate borrowing leading to rising private external debt levels. However, this has not translated into sustained higher investment and in many cases may merely have represented refinancing on more favorable terms. Moreover, small and medium enterprises, which comprise the largest portion of the Region’s economies and generate most new employment growth, have generally lacked access to the inexpensive financing.

Another important legacy effect is the reduced level of, and interest in, regional cooperation. The Region’s economies increased their linkages with the EU and the rest of the global economy during 2000-08, increasing commercial and investment ties and attracting external financing. Intra-regional trade and investment similarly rose during this era. But in the post-crisis era declining cooperation is an unfortunate by-product of the emphasis on domestic consolidation and vulnerability reduction. This imposes significant opportunity costs on the Region’s economies and its firms. Countries need to work with neighbors in areas such as (i) dispute resolution, (ii) dealing with a broad array of common issues including the environment, economic contagion, financial stability, etc. and (iii) building interlinking infrastructure that may facilitate economic activity, enhance efficiency, and reduce transactions costs while sending positive signals to businesses, which in a Region dominated by small companies can then seek to enhance their market outreach, achieve economies of scale, and improve competitiveness.

The 2019-22 MTSBP period is likely to represent a continuation of the pattern of recent years. On current trend, real annual GDP growth is likely to hover in the 2-3% range, with most countries poised to experience stable but low growth. Convergence towards high income levels of the most developed countries will remain a slow and lengthy process. In addition, demographic trends of mostly aging populations and looming skilled labor shortages may create new challenges. On the plus side, countries have developed a credible track record of prudent fiscal and financial management.

While endogenous risks are relatively low, exogenous downside risks are high and include concerns about the international trade regime; fragile geopolitics, including the conflicts in the neighboring Middle East; commodity price volatility; potential stresses caused by continued monetary tightening in the US, and the possibility of the Eurozone reversing its current easy money policies; and, the rising global regime of sanctions and counter-sanctions, the economic fault-line of which left the Black Sea Region front and center, with future tendencies impossible to predict.

However, there also exist upside opportunities that may boost potential growth. Dispute resolution and a re-emphasis upon building cooperation to manage common concerns may improve external perceptions of country risk which remain unduly high, but are a reality with which the Region must cope. In addition, sustained growth in the Region's most important economic partner, the EU, may provide a boost, especially if it is accompanied by re-engagement of the EU. The Eurozone crisis, Brexit, and other EU internal difficulties diminished its post-crisis interest in the Black Sea, politically and economically. This, in turn, increased perceptions of country risk among EU based firms and banks and led to disengagement and reduced private sector interest. More generally, investment, public to some degree but particularly private, will be a key lead indicator for assessing Regional economic prospects for the 2019-22 period and beyond.

4 Going Forward: A Perspective for Transition from Consolidation to Growth

4.1 Review of Activities During the MTSBP 2015-2018 Implementation Period

The Medium Term Strategy and Business Plan for 2019-2022 succeeds the MTSBP 2015-2018 and its attendant Mid Term Review. The institutional and operational achievements (and shortfalls) of the MTSBP 2015-2018 represent an important point of reference for the upcoming strategy period. An independent *Evaluation of BSTDB's Medium Term Strategy and Business Plan 2015-2018* has been prepared separately for the Board of Governors, measuring performance with full explanations and rationales for the assessments/ grades given, and making recommendations. For easy reference, Table 1 below summarizes key indicators achieved during the MTSBP 2015-2018 period:

Table 1: Summary of Key BSTDB Indicators 1 January 2015 – 31 December 2018[1]

INDICATOR	2015	2016	2017	2018
Outstanding portfolio (€m)	1,113.4	1,191.7	1,166.2	1,367.0
Share of NPLs (%)[a b]	1.2%	3.4%	2.1%	1.0%
Positive Evaluation of Operations on Overall Performance	72%	71%	71%	N/A
Capital Adequacy Ratio (%)[e]	55.4%	44.9%	49.3%	48.6%
Efficiency (%)[d e]	43.0%	60.0%	50.2%	57.1%
Operating Income (€m)[b]	41.4	30.8	38.4	17.6
Net Income (€m)[b]	15.2	1.8	8.7	6.0
Return on Equity (%)[b]	2.1%	0.2%	1.1%	0.7%

4.2 Operating Environment

The global financial crisis is generally over, but has left its mark. This crisis, the deepest and longest since the Great Depression, has changed the global economy and financial services industry in ways that are still playing out, with legacy effects that keep emerging. There is still significant volatility in the markets, there is much uncertainty concerning the future of global trade and there are risks arising from monetary policy asymmetry in particular that may have negative implications for the global economy in general and the region of operation of BSTDB in particular.

The Bank has always sought to be flexible and ready to adapt according to changing conditions. Despite facing conditions of considerable adversity and uncertainty, the Bank has developed a high quality portfolio and has sustained profitability.

[1] Notes to Table: (a) NPLs to Total Loans; (b) Figure is estimate for 2018; (c) Share of post-evaluated operations with Excellent or Satisfactory ratings, as reported by DEO (lag-based, 5-year moving average aggregated data). Institutional target is for 70% positive ratings; (d) Defined as administrative expenses relative to revenues (lower value means higher efficiency) (e) Figure is for first half 2018.

However, the extent to which the Bank has achieved prominence, or become a preferred partner in development, constitutes an open question, and BSTDB still has a way to go to achieve greater relevance.

4.3 Medium-Term Strategic Goals

The principal goal of BSTDB over the new Medium-term Strategy period is to achieve higher development and regional cooperation impact, while significantly growing the size of its portfolio (to €2.1 billion outstanding and €2.3 - €2.4 billion signed operations by end 2022).

In order to increase its impact and expand its portfolio, the Bank will aim to achieve:

(i) improved allocation of resources for future operations;

(ii) improved use of financial resources by better matching its liabilities with the risk profile and maturity structure of its various asset classes;

(iii) improved management of human resources by better matching available skills with needs; and

(iv) greater operational and organizational efficiency and effectiveness.

The Bank has established a very strong financial profile- e.g. conservative independent policies; strong capitalization; high liquidity; prudent approach to borrowing, provisioning and investing- which forms the foundation for BSTDB's credibility. However, its business profile is modest, with still limited contribution to the financing of overall development needs in the countries of operation. The Bank shall adjust its Business Model and seek to achieve a stronger business profile through faster operational growth, in order to facilitate achievement of its operational strategic goal. Nevertheless, maintenance and enhancement of institutional credibility remain a prerequisite for the achievement of greater relevance.

The sustainability of the Bank is based upon its ability to employ its available resources productively in order to keep operating independently and fulfilling its mandate. The Bank needs to generate sufficient levels of positive operating income – that would cover the need for provisions and reserves – and positive net income. In addition to smooth ongoing operation, this would permit accumulation of surpluses to improve buffers and support further expansion. To this end, the Bank is dedicated to adopting best practices and attaining appropriate levels of checks and balances that (i) ensure compliance with existing regulatory frameworks, and (ii) enhance responsibility and accuracy without compromising efficiency and effectiveness.

The Bank ensures adherence to, and enforcement of, its institutional and operational framework[2], paying due attention to strengthening and improving the following operational principles:

(i) "quality at entry" of operations;
(ii) control of expenditure;
(iii) supervision and monitoring;
(iv) provision of necessary funding in a diversified, timely and affordable way and in a structure that matches Bank assets to the degree practicable;
(v) systems and procedures for asset and liability management; and
(vi) risk management (including assessment, measurement and mitigation on a consolidated basis of credit, country, compliance, operational, legal, culture and reputational risk).

[2] Included in this "generic" reference are the Agreement Establishing BSTDB, by-laws, policies, strategies, guidelines, rules and regulations adopted by governing bodies (BOG, BOD) and by the Management Committee.

4.4 Areas of Strategic Focus

These operational principles guide the areas of focus, and consequent interventions, in institutional, operational, financial, and organizational terms.

Operationally, BSTDB should focus on the provision of financing for infrastructure development, which will involve focusing on increasing its cooperation with the public sector, in addition to its traditional focus on the private sector. A key shift for the 2019-22 period is the intent of the Bank to increase its emphasis on financing infrastructure development, and consequently operational activities in the public sector (indicative target share of public sector in the total outstanding active portfolio at end-2022 of up to 35%).

The rationale for such a shift in approach includes: (i) the primary role of MDBs is to finance operations with high development impact- infrastructure is such an area and much of its provision tends to be in the public sector, (ii) financing private sector operations is mainly the function of commercial banks and other private financiers, with which the BSTDB does not intend to compete, but rather wishes to be complementary and additional, and therefore will seek to fill existing gaps in financing, and (iii) a larger share of public sector operations improves the risk profile of the Bank's portfolio, a development regarded positively by rating agencies and investors.

Development of infrastructure projects will take prominence in the Bank's business generation activities, and will constitute the main priority of the Bank's growth strategy. This includes, but is not limited to, utilities, energy, transportation, IT and telecommunication, capital markets, airports, ports, municipal and communal services and facilities, and environmental related operations (energy efficiency, water and solid waste treatment, climate change, etc.).

Notwithstanding the shift to more public sector operations, private sector lending will remain a steady and important area of activity, tentatively targeted to represent at end 2022 about 65-70% of the total outstanding value of the Bank's active portfolio. In some countries, the Bank will focus primarily on the private sector. Moreover, as infrastructure is increasingly provided by the private sector, the Bank will seek to work with private providers. In addition, it will continue to provide corporate financing and SME lending- the latter mainly through financial intermediaries. With respect to financing trade, the Bank will continue to provide various trade finance products through specialized banks and agencies. The Bank will seek to increase its capacity to offer trade finance products directly, according to the level of demand for Bank financing, and provided that adequate allocation of internal resources is cost-effective.

Financially, in addition to striving to generate positive net income, BSTDB should consider ways to secure a level and structure of its financial resources that would allow it to remain effective and increase relevance for the Black Sea region. The achievement of long-term positive net income is essential to the Bank's financial sustainability. Notwithstanding this strategic objective, achievement of the main goal of the present MTSBP, high growth of portfolio coupled with the need to show flexibility in pricing, in conformity with market trends for public sector operations, may result in tolerably small fluctuations in net income in the short-run.

Organizationally, there are many areas where the Bank is well structured, operates smoothly and effectively. Nevertheless, the Bank shall critically assess its organization structure from a cost effectiveness and operational efficiency perspective, with a view to eliminating bottlenecks and/or duplication of tasks, streamlining activity, enhancing intra-departmental cooperation and promoting the common goal of fulfilling the mandate of the Bank by focusing on strategic long-term objectives and medium-term goals.

To this end, the Bank shall ensure that it possesses staff with the appropriate combination of skills and competencies so as to be able to achieve the Bank's key medium term goals. A key element of this is human resources management, covering the acquisition and development of needed skills, and ensuring that the mix of Bank staff is experienced, mobile, versatile and adaptable to evolving conditions and requirements.

Institutionally, the Bank needs to develop capabilities for conducting continuous policy dialogue with member countries and other stakeholders, and should expand further its relationship and cooperation with other members of the MDB family, and more broadly with the components of the international financial community and development promoting agencies.

The Bank will continue to explore and pursue available possibilities for attracting new shareholders from among BSEC Member States and internationally reputed International Financial Institutions.

4.5 SWOT Analysis

BSTDB is a development finance institution whose core activity is financing projects and commercial activities, as mandated by the Agreement Establishing the Bank and regulated by relevant BoG approved documents. To achieve relevance, substantial operational portfolio growth is essential.

At current levels of resource availability, and broadly stable expenditure parameters- greater efficiencies and productivity gains are required, while any additional resources need to be externally (and/ or creatively) generated. In order to plan the allocation of resources to achieve the aforementioned objectives and goals, the Bank needs to carefully consider its strengths and its weaknesses, and to take advantage of all opportunities while avoiding threats that may lie ahead.

4.5.1 Strengths

The Bank benefits from a good foundation from an organizational/corporate governance perspective, enjoys shareholder support and due to its size the Bank may find a niche where it can adapt and provide financing more rapidly than other lenders.

Given its significant strengths, the Bank has the potential to scale up its role as a visible and positively active member of the development community.

4.5.2 Weaknesses

In terms of weaknesses, the Bank should concern itself with the risk of slippages due to internal factors, in particular leniency towards allowing small deviations and breaches of rules that may create expectations of tolerance of attempts to rush operations through inadequate or incomplete due diligence and appraisal processes.

Such developments might potentially be detrimental to the Bank’s cohesion and may negatively affect the Bank’s ability to efficiently and effectively fulfill its mandate and achieve strategic objectives and goals.

Weaknesses that reduce the ability of the Bank to undertake on a larger scale various type of financing (e.g. lead arranger of syndications for larger scale project finance operations, direct trade finance operations) range from the technical ability and experience of the Bank staff to engage in such sectors, and the statutory limitations of using some products.

In addition, the willingness of the Bank to focus on primarily achieving the quantitative budgetary targets and easily accept solutions for quick disbursements, and the questionable mandate relevance of some of the activities engaged in by the Bank (e.g. general purpose working capital loans, bank-to-bank loans) or the type and magnitude of risks associated with such transactions for which the Bank may or may not have the appetite to take.

Additional weaknesses that affect the Bank’s effectiveness and need to be addressed are the following:

- Lack of effective marketing/ promotion (either for promotional or market penetration purposes) and active investment relation function (for maintaining regular contacts with potential investors and taking the pulse of the market);
- Concurrently the desired mix of credit quality, volume of business, developmental impact and profitability is not readily available;

- Balancing risk appetite in credit process with business opportunities, at cost covering level of overall interest margins, is becoming increasingly problematic;
- Limited access to financing on desired terms and conditions.

4.5.3 Opportunities

Opportunities may arise from use of new products, extended use of some existing products, becoming more active in lending to overlooked sectors, and in general becoming more proactive and responsive to client demand and market conditions.

Opportunities mostly relate to feasible modalities to increase the size of the portfolio.

4.5.4 Threats

Threats are identified as vulnerabilities to external factors outside the control of the Bank and which may have a disproportionate negative impact on Bank operations. Such threats are mainly related to:

- International sanctions, restrictive trade regimes and protectionist tendencies;
- Adverse impact on Emerging and Developing economies of asymmetric monetary policy of advanced economies;
- Persistent tensions and conflicts in the proximity of the Black Sea region;
- Increased competition, from third parties providing to prospective borrowers better terms and conditions than the Bank.

4.5.5 SWOT Analysis Results

Table 5: SWOT Analysis Summary

Strengths • Strong capital base • Shareholder support • Higher rating compared to member countries • Credibility and solid reputation emanating from the Bank's 19 year presence in the Region • Experienced staff with regional knowledge and professional expertise	***Weaknesses*** • Reduced visibility and lack of promotional and marketing activities in member countries • Limited capacity to engage in very large size project finance, infrastructure, and direct trade finance operations. • Limited experience in lead arranging operations • Limited ability to contribute to large projects requiring high lending volumes
Opportunities • Increased demand for funding from municipalities and important utilities • Intermediation for trade between member countries • Need for continuous financing for development and investment in member countries • Growing sophistication of Regional markets creates new demand • High Regional investment needs for infrastructure but large financing gaps and limited fiscal space create openings • Cooperation with observers and other partners in development for co-financing large scale operations in Member Countries	***Threats*** • Sluggish economic growth in the Region's main partners • Adverse impact on Emerging and Developing economies of asymmetric monetary policy of advanced economies • Tightening of credit markets and widening of spreads • Geopolitical difficulties, persistence of latent conflicts and deteriorating regional conditions • Risk of sanctions for Member States and rising economic protectionism • Increased competition from other IFIs and private financiers with easier access to funding on better terms and conditions than the Bank is capable of securing

4.5.6 Consideration of Internally Originating Constraint

However, the Bank faces certain internal challenges that constrain its operations and do not yet allow it to fully take advantage of existing and emerging opportunities.

A crucial challenge for BSTDB is to achieve such growth while (i) increasing quality and (ii) laying the basis for sustained profitability over the long term. It is made all the more critical by the high cost to the Bank of maintaining liquidity in the current environment of ultra-low interest rates and cheap liquidity. This environment has resulted in a trend of declining margins during 2015-18.

A related phenomenon is that while BSTDB's outstanding portfolio has grown, it has done so at declining annual rates- the average pace of growth has slowed in recent years. This has occurred even though annual operational activity, as expressed by Board approvals and commitments (new signings), was strong from 2015-17.

Reasons for this include:

(i) For a portfolio at €1,200m, the short average tenor of Bank projects- 3.5 at end 2018 (around 4.5 years for non-financial sector projects) implies that over €300m of new operational activity simply replaces existing projects that mature. If the portfolio's average maturity were six years, this figure would drop to €200m and the portfolio would grow an incremental €100m/ year. Assuming quality at entry is maintained, it is efficient to increase operation maturities which may result in increased revenues and reduce cost of holding excess liquidity. The caveat is that, although a high turnover rate of the Bank's portfolio of operations does not support a high growth rate, it improves the perceived risk profile of the portfolio.

(ii) Very high unforeseen prepayment levels that reduce the size of the outstanding portfolio.

(iii) Not all BoD approved projects are signed and not all signed projects fully disbursed. There is attrition, which amounts to wasted effort equal to several hundred million Euros. Some is inevitable, but this waste can be contained and improved ex-ante via assessment of client commitment, and measures such as reimbursable good faith payments and higher commitment fees.

(iv) The average size of projects- €10.8m at end 2017. Prudently increasing this number can achieve growth and efficiency gains for the same amount of work.

5 Operational Strategy

5.1 Geographic Concentration

BSTDB seeks to always be ready to support financially viable and economically sustainable operations in its Member States. This is especially true for operations with demonstrably high development and/or regional cooperation impact, for which the Bank may opt to allocate country limits dynamically for a given period. This important principle is balanced by the desire to maintain an adequate presence in all the Member States and to provide value added in areas which may be underserved. Not only is it important to be present in all Member States from a fairness perspective, it is also a good risk practice from the perspective of diversification. The Bank will seek to maintain the country HHI below 1400 and will welcome further reductions as it seeks to improve coverage in underserved countries.

Cascading to Member State level, how the Bank might increase relevance would differ from country to country. It would involve enumerating country strategies with a mix of quantitative and qualitative targets. Quality is assessed by the extent to which an operation achieves development and regional cooperation impact, alongside the financial profile of the operation, and other key parameters such as quality of corporate governance, environmental and social outturns, and other positive externalities are realized. In smaller and/ or countries with financial sectors lacking depth, increasing volumes of BSTDB financing can make an appreciable difference in the local economy together with the qualitative elements, whereas in certain larger countries with deeper financial markets, the absolute levels of financing provided by the Bank will have a lower relative effect, and the key challenge will be to apply resources in an impactful, high quality manner. The Bank will continue to aim to maintain the share of small shareholder countries in the outstanding portfolio of operations at least at 20%.

As regards individual country targets, they will be enumerated in each country strategy to be prepared with a view to approval by the Board of Directors after the MTSBP 2019-2022 has been approved by the Bank's Board of Governors. A key indicator of progress is the Bank's achievement of at least 80% of the targeted level of commitments (signed operations) for each country. Where there is a risk of shortfall, the Bank will take targeted measures to focus greater attention and seek to rectify the situation.

5.2 Sector Priorities

An appropriate sector distribution is critical from a risk management perspective, but also in order to achieve broad coverage into important sectors of the economy that are key to achieving development.

5.2.1 Emphasis on public operations

BSTDB has encountered difficulties seeking to increase its share of public sector operations, with public operations accounting for slightly more than 10% of the total outstanding portfolio, compared to the MTSBP 2015-18 target of 15-20%. Growth in a way that enhances the business profile of the Bank will require an increase in the share of public sector operations. This objective coincides with the desire of the Bank to emphasize infrastructure development, since it represents the principal component of public investment. The emphasis on public sector operations will also require a flexible yet strongly-principled approach to the procurement features of such operations.

The Bank intends for most of the growth over 2019-2022 to come from the development of public sector operations, with the intention that they grow to represent approximately one third of the total portfolio by the end of the strategy period. The Bank will seek to obtain a sovereign guarantee where possible, as this will permit the provision of more attracting pricing terms to the client while conferring a more favorable risk profile to the Bank's portfolio.

Maintenance of portfolio quality, in light of the growth target envisioned by the medium-term strategy, would require that public sector (national, regional, municipal, communal services) lending would need to expand greatly, up to approximately €700 million by end 2022. This, in turn, will require a pricing approach that is in line with the market for such operations.

While resources will necessarily shift to development of public sector operations, the Bank intends for its private sector portfolio to continue to grow, albeit at a more moderate average rate, so that it reaches approximately €1,400 million at the end of the strategy period.

Support to private non-financial corporate clients will be provided to fill financing gaps, since it is important for BSTDB to be present and available for regionally based firms which may encounter difficulties in accessing financing. This is especially important for medium sized companies with high growth potential which may have a limited track record, and/ or be located outside of principal business centers, and which therefore face challenges in trying to secure financing needed to grow and expand to new markets.

5.2.2 Indicative distribution by Sector

Turning to sectors of activity, an appropriate sector distribution is critical from a risk management perspective, but also in order to achieve broad coverage into important sectors of the economy that are key to achieving development. By 2022, the Bank expects direct operations to comprise 70-75% of the portfolio, and intermediated operations to comprise 25-30%. See also Table 9 in Section 12.1 for a summary depiction of sector targets.

The Bank intends to increase its presence in the broadly defined infrastructure sector, in both the public and private sectors, to account for up to 50% of direct operations (35-40% of the Bank's overall portfolio). Broadly defined infrastructure includes energy, IT and telecommunications, transport, ports, airports and utilities (including fee-based municipal services and facilities) etc., as these tend to have high cooperation and development impact, as well as economic and social returns that exceed the financial returns of the particular operation financed,

Within energy, special attention will be given to developing the portfolio in the area of environmental clean-up and renewable energy. For fossil fuel operations, the Bank will prioritize those with positive environmental elements (e.g. clean-up, pollution reduction, increased efficiency, cleaner generation). Increasing the share of renewables in the energy mix is an important part of the Global Sustainable Development Goals, and it is an increasingly high priority for many Member States, in order to meet emission standards, and to diversify sources of energy generation. This includes all key renewables, hydropower, but also wind and solar power generation, for which technological progress in recent years has tremendously improved efficiency. This is an important consideration since in the past subsidies to renewables were a burden on public finances and/ or consumers. This problem has diminished significantly in recent years, and if positive externalities of renewables and the negative polluting externalities of fossil fuels are incorporated, renewables projects have become very competitive.

Other 'real' sector operations (manufacturing, processing, etc.) will make up the rest of the direct portfolio. These include the long running support to general industries and agribusiness for investment, expansion, and working capital, as well as other corporate loans- such as direct trade finance. There will be variation in exact type, and in the distribution among Member States. Sector distribution, and therefore concentration, depends upon specific country conditions, needs and priorities, and will be determined at the level of Country Strategies. Support to corporate clients will also remain an important part of the Bank's activities, even if its share declines. It is important for BSTDB to be present and available for regionally based firms which may encounter difficulties in accessing external financing. This applies to well-established regional firms, but it is especially important for 'second tier' firms- companies with high growth potential which may be medium sized, have a limited track record, and/ or be located outside of principal business centers, and which therefore face challenges in trying to grow and expand to new markets.

The financial sector will remain an important area of activity. This sector contains all types of intermediated financing through financial institutions, including SME lending, trade finance, direct bank to bank lending, subordinate loans, leasing, etc. BSTDB succeeded in increasing its 'real' sector activities so that its share of operations in the financial sector fell below 40%. For 2019-2022, intermediated operations will account for 25-30% of the portfolio, with priority given to expanding trade finance operations where possible, and to maintaining SME lending, with leasing and factoring also supported. These are the areas most directly linked to 'real' economic activity in other sectors of the economy and help to promote priorities such as economic development, improved export performance, new employment generation to the greatest degree.

Use of financial intermediaries is especially important in smaller economies in which the majority of firms are small or medium in size. While maintaining a trade finance presence up to 30% of the intermediated portfolio, the Bank will commission a feasibility study on trade finance in the Region, so as to ascertain the size of the potential market and the degree to which they Bank may consider investing in the establishment of a dedicated trade finance program in the latter part of the MTSBP period.

The HHI monitoring tool is also applied to monitor sector distribution, although the predominant role of financial institutions tends to inflate the figure. The Bank will seek to keep the sector HHI below 2200 over 2019-2022.

5.2.3 Climate Change Financing

BSTDB is aware that climate change affects directly the natural environment, human health and wellbeing, business and national economies. Thus, it affects development and the ability of national economies to sustain growth and alleviate poverty. The Members States of BSTDB, to differing degrees, are vulnerable to climate change, and the Bank's effort to decrease their vulnerability to date has been mainly through financing operations that reduce emissions, apply energy efficiency, cleaner production, and use of renewable energy sources. While such operations had unquestionably a positive impact, the Bank can achieve much more in addressing climate change at both strategic and operational level.

In this respect BSTDB needs to mobilize more capital to help shift national economies to a low carbon model, and it needs to develop its capacity to help its Member States. At present, the Bank is developing its first Climate Change Strategy that would allow BSTDB to provide more targeted support to the private and public sectors in combating climate change, building resilience and adaptation, and decreasing their vulnerability to the effects of changing climate.

5.3 Financing Instruments

Direct lending

Direct lending has been and will remain the Bank's principal financing instrument. Within lending, the Bank will prioritize direct lending to project finance activities in priority sectors- targeted investment programs which specify where and how financing proceeds are to be applied.

General purpose corporate loans will be employed strategically where they may have greatest impact or where they demonstrably promote activity in underserved areas. They represent an important way to maintain a presence in the marketplace, to develop and maintain client relationships, and to diversify activities. This is particularly the case in small countries and remote areas where generation of large operations is difficult. Corporate support which helps promote exports will be especially important, and the Bank will seek to provide more direct trade financing support to exporters for larger sized transactions, using term loans, credit lines and discounting facilities (as well as guarantees).

Where needed, the Bank will support regional cooperation and expansion of regional companies in other markets (primarily in member Countries but also in markets outside the Black sea region), including via financing of mergers and acquisitions, especially for opportunities with high expected development and regional cooperation impact.

In certain cases, bond participations may be used as a vehicle (i) to facilitate financing (e.g. for sub-sovereign public entities), (ii) to enter an underserved market, or (iii) in instances where the Bank may act as an 'anchor' investor for a new issuer, for operations which have demonstrated high mandate fulfillment potential, and/or may help the issuer attract additional external financing, on more favorable terms, than would otherwise be the case. This also includes alternate lending arrangement such as bond loans that may not be actively traded in the market.

Mezzanine financing

As the Bank intends to expand greatly its portfolio of infrastructure operations, in particular in the public sector, it may increase the use of specific instruments such as mezzanine, bridge and off balance sheet financing in addition to term-loans, for project finance.

Lending through financial intermediaries

Generally, the Bank takes the risk of the intermediary, not that of the end recipients; exceptions to this will be considered for operations which possess high mandate fulfillment potential.

Credit lines are the principal form of financial assistance for reaching out to SMEs, and for the provision of trade financing for smaller sized transactions (pre-export finance, import financing, etc.).

Leasing and *Factoring* operations will also be financed mainly through intermediaries.

Syndication participations

The Bank will participate in syndications and other types of co-financing agreements along other MDBs and other co-financiers, for infrastructure and public sector projects, and will seek to develop gradually greater capacity in lead arranging syndications, so as to expand resource mobilization potential and enhance its profile in the marketplace.

Furthermore, in periods of high liquidity, participation in syndications may be considered in order to 'put resources to use' more efficiently.

Refinancing

To be strictly limited, and provided on a case by case basis according to degree of mandate fulfillment, importance for shareholders and conformity with Bank policies. A notable exception to this is potentially high impact operations that promote the development of secondary markets in Member States, or contribute to the expansion and deepening of financial market infrastructure, for which securitization participation may be required.

Convertible loans/bonds

The Bank will generally avoid providing convertible instruments for 'real' sectors, except in cases which demonstrate high mandate fulfillment potential.

Subordinated debt

This is a high risk product with limited earning potential. It has the same unlimited downside as equity, but lacks the upside. In times of crisis, subordinated debt is subject to the regulatory risk of being immediately in line to receive 'haircuts' just after equity, or in special circumstances even before equity, or may be subject to discretionary conversion into equity on highly unfavorable terms. Therefore it is difficult to calculate ex-ante the risk-return profile of operations involving the use of the instrument. Since its treatment under Basel III rules is highly unfavorable, the Bank will avoid using subordinate debt as a rule, and will enter such transactions where there is high expected mandate fulfillment potential.

Local currency facilities

Based on demand in certain Member States, the Bank initiated financing of operations in local currency (LC) in 2015. LC financing can help to broaden and deepen local financial markets, and thus contribute to their further development. The Bank will undertake LC lending in jurisdictions where a Member State is open to such activity, with priority to those countries where LC financing is encouraged, and it will allow the level of LC lending to be determined by market demand and increase the availability of LC products. Per its existing policies, the Bank will not take any currency risk.

Like other development banks, BSTDB was established in order to mobilize external resources for the benefit of economic entities active in its Member States, this remains the principal way it provides value added to its shareholders, and therefore such lending will continue to form the bulk of its new operational activity.

Equity

The Bank has reduced the provision of equity in recent years because it is considered riskier, and it receives a significantly worse risk weighting than other instruments, thus eroding the quality of the Bank's capital more heavily for a given amount.

Equity will be employed sparingly, and only for operations which can demonstrate very high mandate fulfillment potential, such as that it generates benefits substantially in excess of what lending would achieve. Possible examples include (i) PPP investment projects, and (ii) instances where Bank involvement would considerably leverage mobilization of additional resources.

The Bank will normally avoid contributing to equity funds and entering into equity transactions without a clear and credible exit strategy.

Off-balance-sheet financing

The Bank will be open to provision of off balance sheet instruments such as guarantees- including unfunded risk participations- especially where these improve external mobilization of financing for clients.

Use of non-disbursing instruments in the past has been determined either by (i) specific demand from clients for a guarantee or related product, and (ii) periods of tighter liquidity (or uncertain access) during which alternatives to directly disbursing projects become more attractive. As BSTDB has grown and developed a presence in financial markets, the latter component has significantly diminished in relevance and instead, provision of guarantees represents a matter of strategic choice. Given the emphasis on direct portfolio growth, off balance sheet activities will likely continue to be demand based. BSTDB will be ready to respond to requests in the marketplace, and, as needed, will expand internal capacity in this regard.

5.4 Size of operations

Between 2015-18, the average size of signed operations, €19.3m, grew significantly relative to the average from 2007- 2014 (€11.7m). This growth was observed mainly in large shareholding countries, which tend to have bigger economies and greater numbers of large firms, and to a lesser degree, in small shareholding countries. However, there is a notable difference in the average size of new signed operations, since in larger shareholding countries they averaged €24.5m, while in smaller shareholding countries the average size was €11.6m.

It is expected that over 2019-2022 new operations will continue to increase in size on average to around €22m, since the infrastructure operations, which will be a key priority for the Bank, tend to be larger. Larger operations also tend to be more cost efficient, since the required amount of resources to prepare an operation does not necessarily depend on size, so for the same amount of work more financing will normally be put to work. The difference in the average size of operations in larger versus smaller shareholding countries is likely to remain.

For direct lending, the Bank will seek operations larger than €20m in larger shareholding countries and will apply a minimum size of €10m, whereas for smaller shareholders it will generally consider a minimum size of €5m, with the proviso that the costs of Bank participation in the operation must be fully covered (e.g. not loss making). Exceptions to the minimum sizes may be made on a case by case basis- subject to the requirement that the Bank fully covers its costs- for reasons such as (i) strategic presence, (ii) mandate fulfillment, or (iii) helping in underserved areas.

5.5 Maturity

The average tenor of Bank projects stood at approximately 3.5 years at end 2018. This implies that nearly 30% of new operational activity in a given year replaces existing projects that mature. Assuming quality at entry is maintained, it is more efficient to increase operation maturities, increase revenues, and reduce cost of holding expensive liquidity. This overall tenor figure on its own is somewhat misleading, since it contains financial projects for SMEs and trade financing, which have short maturities, but are rolled over regularly and can go on for years. Hence such projects keep finances ‘working’ and are desirable. Notwithstanding this detail, the average tenor for non-financial projects is 4.5 years, which is also relatively short and indicative of how the Bank has been geared more toward corporate financing as opposed to project financing in the past.

Project finance and infrastructure operations will normally have medium to long-term maturities (from five to 15 years). For operations exhibiting high mandate fulfillment potential, this may exceed 15 years. Corporate loans will likely be for medium-term (three to seven years). Trade finance products for direct operations and SME products tend to be medium-term (two to five years), while provision of trade finance through intermediaries and credit lines are generally short-term (but may go up to five years). Since infrastructure projects will be the main priority area of the Bank's growth strategy, it is expected that the overall average tenor will rise to around 5.0 years.

5.6 Concentration Limits

The Bank will seek to provide larger amounts appropriate to the type of operation financed, and consistent with its strategic goals to increase relevance and accelerate the rate of portfolio growth. For certain high profile/ high quality operations in the Black Sea Region, the threshold for involvement of a financial institution needs to be such that it makes business sense for the borrowing entity to be willing to take on the extra burdens and costs of including an additional lender. In the past, the Bank's internal limits were excessively restrictive, excluding the Bank from participating in marquee Regional operations with high development and cross-country cooperation features.

For private sector operations which demonstrably have high mandate fulfillment potential, the Bank may apply a 'higher' 10% single obligor limit (SOL) of paid-in capital, reserves, and surpluses to a single exposure. For public sector non-sovereign operations, the maximum exposure shall remain up to 15% of paid-in capital, reserves, and surpluses. For special circumstances of project finance and public infrastructure projects, the SOL applicable to the public sector will be raised to the maximum of 20% of paid-in capital, reserves, and surpluses. Nevertheless, exposures in excess of €120 million will be considered very carefully.

These will be the limits applicable to all operations, as existing percentage share limits for project finance, corporate finance, and trade finance have created inconsistencies in application of policies, and have generated confusion/ frustration depending upon the classification accorded to a project. In other words, the aforementioned SOL limits will apply as described, and while the Bank will seek to mobilize financing from external sources to the maximum degree possible for the benefit of its Member States and individual clients, it will not restrict itself to the project/ corporate/ trade financing share of total project cost limits per se. Naturally, the Bank will seek appropriate risk mitigants, as well, in line with its existing rules.

For private sector project finance operations only, The Bank will use its existing 35% threshold of project cost as a guideline for the Credit Committee, for reasons of risk mitigation and to encourage resource mobilization.

Existing Bank policies limit the sector concentration limit to 40% of the portfolio. In order to permit greater flexibility to satisfy country needs and priorities, and to shift the focus of operational activity to include large value, long maturity infrastructure projects, the Bank may consider increasing the sector exposure limit to 50% of its portfolio.

6 Financial Strategy

For BSTDB to successfully finance development while preserving financial strength, two elements at play have to be concomitantly addressed, the more so as they tend to reinforce each other: one is the cost of capital, the other is portfolio quality, neither of which can be effectively sustained without the maintenance of strong financial positions.

One key requirement is to sustain the high capitalization and other financial ratios, such as risk adjusted capital (RAC) and capital adequacy (CAR), at levels qualifying the Bank for maintaining the 'extremely strong' classification of the 'financial profile'. This achievement requires a solid capital base and strong operating income levels. Consistent positive net income levels allow for increases in reserves and thus shareholder funds (paid-in capital plus reserves and surpluses).

Other measures to improve financial position aim to:

(i) reduce borrowing costs;
(ii) active liquidity portfolio management and cost efficiency in mobilizing short and long term market funding (including timely utilization of unused funds with commitment charges); and

(iii) appropriate control of administrative expenses, while securing the necessary capacity to achieve safely the ambitious strategy goal.

Reduced cost of employed capital may be achieved as a result of a combination of factors:

- First, there is the benefit of a high quality portfolio, with an optimal maturity structure which ensures a natural portfolio turnover that does not stretch liquidity requirements for a constant flow of new operations.
- Second, it requires demonstrated support from shareholders (contributors and borrowers at the same time).
- Third is the proportion of “free” capital in total employed capital (ordinary capital resources), which in practice means a high (from a minimum of 30% and up to 50%) proportion of shareholder funds relative to borrowed funds (desirability of such ratio is inferred from Article 8 of the Agreement Establishing BSTDB, and practice of other relevant RMDBs). Paramount to this is again portfolio quality as demonstrated by a reduced proportion of write-offs, low need for provisions, and consequently low cost of collection.

Income from the management of liquid assets can be raised by increasing the resources at the disposal of the Treasury for investment in capital markets assuming higher market risks. However, this source of income is subject to capital market volatility.

Active portfolio management implies the use of techniques that accelerate the normal turnover of portfolio and generate liquidity needed for funding new operations.

Active pursuit of portfolio turnover entails a multi-faceted approach:

- reduction of idle commitments (signed but not disbursing operations): continuously scrutinize outstanding commitments in order to eliminate any idle commitments. The capital tied-up in such commitments could more efficiently be allocated to other promising project proposals.
- increased raising of external funding: The greater the success of external fundraising at desired maturity structure, the higher the number of projects BSTDB will be able to accept given its capital base.
- Increasing the available number of instruments in which the Bank may invest in order to improve management of liquidity and income generation, and achieve greater product diversification, including by enabling investments in Member State bonds.

In developing initiatives to revolve its portfolio, BSTDB shall consider the impact on:

- *project*: First, BSTDB should ensure that its role in the investment project has been essentially completed. Second, BSTDB should refrain from exiting investments which still require an active involvement in the obligor’s corporate governance. Third, BSTDB should also be sensitive to (negative) reactions from customers and markets to any disposal of its investments.

- *portfolio*: BSTDB should assess the impact of the sale of its assets on the risk profile of the remaining operational portfolio. Any sale of one of the most creditworthy investments may result in a deterioration of the quality of the portfolio, if the proceeds cannot be re-invested into assets with equivalent or better risk-return profile.

- *income*: BSTDB should assess the impact of any asset sales on its net earnings. The proceeds from the sale of relatively high earning operational assets will temporarily be invested in relatively low earning liquid assets. The differential return between operational and liquid assets could result in lower income in the short term until the liquid assets are re-deployed into operational assets, which could potentially generate a lower return than the original investments as well.

- *preferred creditor status*: BSTDB should structure portfolio turnover initiatives so as to minimize the risk that any preferred creditor status of its loans might be questioned.

6.1 Income management

The management of income reflects the growing pressures and conflicting demands faced by BSTDB. Achieving an appropriate balance between the three main functions of any MDB (financing development, development assistance, and provision of public goods) involves difficult decisions on the size and the allocation of operating and net income:

- First, there is the need to use net income to increase reserves and strengthen financial position and risk-bearing capacity.
- Second, there is a need to improve management of expenditures and to contain the growth in administrative expenses that result from a shift to more complex operations, higher levels of highly trained and experienced staff, as well as a larger presence in the field (e.g. more frequent travel to meet clients and stakeholders).

The sources for consistently positive net income are strong operating income levels and good portfolio quality (resulting in low provisioning expenses and low cost of capital). As far as operating income is concerned, income from loans, guarantees and equity investments can be raised either by increasing the volume of exposure or by increasing charges. However, due consideration needs to be paid to the risks entailed by increasing the size of each operation and possible implications for BSTDB's competitiveness.

6.2 Bank Capital

By the end of 2018, the final installment from the Bank's 2008 capital increase will have come due, bringing to a close a very important and successful exercise that demonstrated tremendous Shareholder commitment to the institution and has permitted the Bank to mobilize additional resources for the benefit of the Region, and to grow operationally in a measured, organic manner. Paid-in capital is projected to be € 686.5 million, and together with the callable capital which corresponds to the amount paid-in brings the total Bank subscribed capital to € 2,288.5 million.

An important institutional consideration concerns how much available 'headroom' the Bank has for portfolio growth under its operational gearing ratio. With the portfolio reaching € 1,367 million at end 2018, and the maximum portfolio under the operational gearing ratio estimated at € 2,400 million; then the available headroom would be an estimated € 1,033 million. Accumulation of additional reserves and surpluses from net income during the MTSBP period will lead to an increase of the €2,400 million in an equal amount, but not by enough to increase the figure appreciably. In turn, this implies that successfully growing the outstanding portfolio to the projected € 2,137 million by 2022 would leave only €300-350 million in headroom for further growth before hitting the limit.

An additional capital related issue that is pending concerns the € 3.45 million which remains unallocated in the aftermath of the 2008 capital increase. The persistence of this issue has negative implications for the perception of BSTDB, particularly on the part of credit rating agencies. They view it as a symbol for lack of shareholder support to the institution, despite the minimal importance of the amount involved, especially since it resulted from a reduction in subscribed shares. Resolution of this issue by uptake of this amount- preferably by a small shareholding Member State- would accomplish a disproportionately large perceptional benefit.

6.3 Resource Mobilization

This is a critical indicator of the success of any MDB. Shareholders invest equity capital in the expectation that this capital will be leveraged in order to mobilize additional resources.

6.3.1 Borrowing

The first manner in which the Bank mobilizes such resources is through its borrowing program, which adds to the Bank's ordinary capital resources and is applied alongside the equity in the operations that are financed.

At end 2018, borrowings total around €952 million. Under the MTSBP 2019-2022 Base Case Scenario of Growth, the Bank will need to increase total borrowings to around €1.5 billion by end 2022. Since all but €100 million of the existing end 2018 borrowings will mature during the four year period, the Bank will need to obtain new borrowings of around €1.4 billion over the period, from a diversified array of funding sources which it has carefully built up and managed over the years.

The Bank will explore access to all potential sources of funds in all markets, and will seek to secure funds on best available terms, starting with cheaper short-term funding through use of various instruments, and gradually moving to longer term borrowing.

6.3.2 Co-financing

A second important way in which the Bank mobilizes additional resources is via co-financing, bringing other private and public financiers to participate in an operation. Indeed, Bank policies limit the extent of own participation in certain operations in order to require the mobilization of additional resources. Such co-financing is usually one of three types (i) parallel- with separate legal agreements with the borrowing entity, (ii) joint- where financing is funneled through one lender of record, or (iii) via credit lines from other institutions. Since co-financing can achieve a high multiple of financial mobilization for a given operation, and can share risks broadly among participants, the Bank will continue to seek high degrees of co-financing in the operations in which it participates, and it will seek to develop its capacity to prepare and lead arrange operations, whereby it originates and prepares operations, and attracts co-financiers from the private sector as well as the official sector from outside.

Such activity requires additional staff and resource costs and may entail reputational risks since it puts the Bank in an intermediary position between the borrower and the lender(s), but it also raises the profile of the institution, demonstrates that it is attracting external resources for the benefit of the Region, and can generate fees for BSTDB.

6.3.3 Special Funds

A third method of resource mobilization is via Special Funds. BSTDB has had limited success in developing special funds for activities such as co-financing, research, regional promotion, and technical assistance. Bank capacity in this area remains limited, and the lack of special funds represents an opportunity cost, since they can underwrite innovative and more risky activities with high mandate fulfillment potential. Moreover, they may support development of operations which have higher upfront costs, and in the case of co-financing can help to lower the effective borrowing cost faced by clients. Special funds also represent an opportunity to cooperate with Observers and to approach interested new entities that wish to become active in the Black Sea Region. The Bank will seek to develop special funds with Member Countries and in particular will gauge the possibility of setting up a Regional Special Fund open to participation from all Member Countries.

Green Climate Fund Accreditation

In parallel to the preparation of its climate finance strategy, the Bank intends to apply to the Green Climate Fund (GCF), a global US$ 100 billion fund to support climate mitigation and adaptation activities (including renewable energy generation). Given BSTDB's current status, it would be easier to seek accreditation at the level of accessing concessional loans. Indeed, BSTDB already has the financial standards and many of the rules and procedures in place since it follows MDB best practices, although it would need to develop a gender policy. GCF accreditation would enhance the business profile of BSTDB and improve access to climate financing on more favorable terms for the benefit of Member States.

6.4 Pricing of Operations

The pricing of Bank operations incorporates relevant risk factors and the tenor together with the requirement that revenues cover operating and administrative costs, and permit the institution to accumulate reserves and surpluses sufficient to absorb expected losses and make adequate profits.

From time to time, the Bank may consider adjustments to its pricing methodology in order to facilitate the execution of its strategy, and enhance its ability to provide more tailored and more attractive pricing to borrowers. In other words, the pricing of Bank operations should more specifically reflect the market situation on the one hand, and the risk of each type of asset and the specific cost of funds on the other hand. This does not necessarily imply cheaper pricing, but rather that the cost of funds would reflect reality in a more sophisticated and immediate manner.

The achievement of adequate profitability is essential to the Bank's long term health. However, pursuing a strategy of sustained, high impact growth may result in short term fluctuations in net income. So long as the 'big picture' of quality growth is maintained and the Bank aims to maintain positive bottom line results, temporarily negative outturns may be observed due to squeezed margins in sovereign operations rather than an increase in assumed risk.

BSTDB remains committed to reducing its lending costs in a steady, sustainable manner. For this to be feasible, the Bank needs to control its operating costs and to reduce its own borrowing costs. A high growth strategy can facilitate both, since it reduces the share of the administrative costs relative to the overall portfolio, and it necessitates a more regular presence in markets. Borrowing costs are positively influenced by establishing a track record and greater familiarity with investors, although such costs are also affected by exogenous factors such as market conditions, perceptions of risk and credit ratings.

6.5 Risk Assumption Considerations

The Risk Bearing Capacity (RBC) of BSTDB, taking into consideration its internal culture, structure and strategy, defines the Bank's risk appetite and tolerance to the financial impact of risk. The Bank's credit rating is a key factor in determining its borrowing costs, and the Bank will seek to maintain it, at a minimum, and to enhance its credit profile (and business profile) so as to lay the ground for an upgrade.

The proposed shift in priority operational activities, and consequent change in business model, entails a calculated increase in the risk assumed by the Bank in its portfolio. Projects of bigger size and longer maturity, in conjunction with a larger SOL (in specific instances) and higher own participation shares, increase the risk assumed by the Bank in its operational portfolio, while the Bank's RBC and loss absorption capacity remains unchanged.

The Bank's credit rating has played a critical role in establishing the Bank's credibility, and the Bank is committed to its maintenance and enhancement; indeed, that is an underlying objective of this MTSBP's emphasis. The Bank follows closely potential implications of rating actions (upgrade/downgrade) with respect to market access and cost, collateral requirements, ability to open and maintain correspondent bank accounts for treasury and banking operations, etc.

7 Institutional Strategy

The Long-Term Strategic Framework 2010-2020 stresses the focus on development results and recognizes the importance of institutional reforms which underpin achievement of desired outcomes in order to increase the Bank's relevance. This includes ensuring continued progress in the following key areas:

(i) improve quality at entry in operations by strengthening analytic work and the due diligence processes, particularly with respect to the extent to which an operation meets the development and regional cooperation mandates of BSTDB;

(ii) build stronger monitoring and supervision systems in operations, in order to attain higher impact while controlling the risk-return profile of operations;

(iii) further enhance a results-focused culture by strengthening:

  a. results oriented supervision reporting systems, and

b. mid-term review processes to facilitate better results;

(iv) enhance and consolidate risk management systems and controls, in line with evolving best practices;

(v) establish standardized targets and outcome indicators, including sectoral benchmarks;

(vi) enhance learning and accountability through:

a. evaluation of results-oriented completion reports, and

b. stronger feedback loops from lessons learned to new operations; and

(vii) improve systems and procedures for results reporting, through upgraded portfolio management systems.

Increasing relevance will also need to be supported by the following externally focused actions:

Promote "networking effects":

- Facilitate involvement in the Black Sea Region of partners in development
- Enhance cooperation in various fields within a select group of institutions
- Seek to identify and provide funding for larger size operations

Improve transparency of operation:

- Enhanced appraisal, due diligence and review process, consultation, relevant disclosure

Improve information sharing & greater policy coherence and consistency:

- If requested, the Bank could assist in the planning and coordination of various TA operations which are being carried out at a national or regional level
- Creation of a bigger knowledge base

Generate positive externalities (demonstration effects, upstream/ downstream linkages, mitigating 'free-rider' or moral hazard issues, etc.):

- The Bank will be more active in dialogue with partners, as a way to:

  a. mobilize knowledge resources
  b. share experiences
  c. design and coordinate policy responses, and
  d. engage in promotional activities

- Expand the Bank's capacity to attract grant and other donor resources to facilitate: (i) innovative or riskier but high impact operations, and (ii) operational support activities such as: (a) technical assistance, (b) Regional studies, (c) training, and event sponsoring

Increase visibility:

- For the Bank within the Black Sea region, as it reaches out to potential clients to become better known to them, and to offer them an important additional option for financing and risk mitigation
- For the Bank outside its region of operations, as it will participate in various fora (Interact Group, IIF meetings, IDFC, Working Groups of IFIs such as: General Councils meetings, Evaluation, Corporate Governance, Environment, Procurement, etc.)
- For the Black Sea region itself through promotion by the Bank through presentations and seminars, and provision of financing in conjunction with other partners
- Increase active presence at international conferences and forums

Marketing considerations

Preparation and implementation of a comprehensive and cohesive marketing strategy for BSTDB is needed. Current marketing is piecemeal and greater coordination is essential. BSTDB needs to maintain its profile in the international development community and to increase its presence in financial markets, in particular with potential investors and co-financiers, so that it can expand and diversify its resource mobilization. In addition, it needs to improve its visibility inside its Region of operation, so as to become broadly known among potential clients as a financing and risk mitigation option whenever they consider investment or commercial activities. This will require targeted roadshows, conferences and other promotional events, as well as greater collaboration with shareholders, as they can efficiently assist the Bank (i) to gain greater prominence in the local marketplace, and (ii) to obtain better access to high profile financing opportunities.

Representative Offices

The Bank will explore the possibility of establishing representative offices in one or more Member States towards the latter part of the strategy period, subject to business volume expectations, as well as considerations of cost and balance.

7.1 Expansion of Membership

Among BSEC Participating States, the Republic of Serbia is the only country that has not yet joined BSTDB. The Bank has held discussions with high level government officials in Serbia about potential membership, and will continue the process as necessary over the 2019-2022 period. The Bank will explore the prospect of extending membership to other regional states that might wish to join BSTDB. The Bank will also pursue the possibility of International Financial Institutions (IFIs) joining BSTDB, in particular from highly rated IFIs with a large presence on the global development stage. This could provide a mutually beneficial opportunity allowing the interested IFI to enhance its presence in the Black Sea Region, while also providing a boost to the Bank's credit and financial profiles.

8 Organizational Strategy- Issues and Considerations

The Bank needs to move further towards a flat organization that promotes open communication across divisional boundaries, encourages creativity, assumption of personal initiative, and team work. BSTDB needs to consider how appropriate the current structure is, and to keep in mind not just realities, but also external perceptions, given that in the current business environment the latter have a high and growing impact upon funding and investment decisions - perception is an important factor in decision making and in determining how events unfold.

Governance issues

Although the current organizational and governance structure of the Bank are not a constraint on faster growth, certain adjustments may be needed - in particular (i) creation of a dedicated marketing/ promotion function that would facilitate business generation, (ii) establishment of a dedicated and independent from operational activities project management function; (iii) re-alignment of banking departments to increase inter-departmental cooperation and incentivize new project generation, and (iv) development of consistent and compatible key performance indicators (KPIs) parameters across the Bank. Increased trade finance and sovereign lending may require additional and specialized manpower.

Removing institutional 'compartmentalization'

Instead of desirable constructive cooperation, compartmentalization may generate disruptive competition among units in same division, reducing productivity and undermining overall goal achievement. Therefore, the tendency to compartmentalization and exclusivity needs to be contained. Performance evaluation can be an important tool for the removal of such 'silos', with synchronization of KPIs and greater staff accountability playing a key role.

Improving Banking Division incentives

Bankers' performance is mainly assessed on project volume. Quantitative measures should be supplemented by profitability/ earnings targets, while qualitatively greater credit should be given to projects which (i) better fulfill the Bank's mandate, or (ii) are undertaken in countries which are small and/ or project generation is difficult.

Role of support & review departments

Segregation of activities with independent support and review roles must be maintained, but communication channels can be improved and transparency enhanced. Support/review units should be able to communicate directly with clients as needed, under the coordination of the operation leader. Concomitantly, support/review units should provide consistent, timely rationale for their inputs, and in writing. Greater clarity, certainty and consistency of commentary by units involved in appraisal and due diligence would help align expectations and reduce misunderstandings and time wastage.

Automation and IT support

Transparency and reporting channels should be upgraded for project information - who is involved and where, the status of the operation, identification of checkpoints during preparation. New IT software may assist and improve real time information provision.

The IT structure and attendant personnel needs shall be in place to be able to deliver the IT strategic goals and objectives. The IT Strategy shall be reviewed annually to make sure that is aligned with the MTSBP 2019-2022 and its goals and objectives. Any changes which may occur during the year shall be reflected in the IT action plan for the implementation of the IT Strategy.

8.1 IT Strategy

The mission of the IT is to support and sustain the business needs and objectives of the organization and create value by delivering IT services, products, and innovative solutions to enable business growth and meet future challenges.

The Business Strategy shall be the leading driver for the design and implementation of the IT Strategy. The alignment between Business and IT Strategy will define the success of the IT Strategy implementation. Therefore, as the business strategy is evolving, continuous enhancements to the IT Strategic themes and objectives shall take place to ensure that IT is a key business enabler, delivering value to the business. Additionally, the business "demand" for IT Services should enrich the key IT Strategy themes and play a decisive role in the formulation of the IT Strategic Masterplan.

The digital business transformation and insight to data and information will require a modernized platform approach that supports automation, predictive analytics, information governance; and especially through a centralized, consolidated, and integrated IT architecture. With the emergence of disruptive technologies and Cloud, the Bank should also consider adopting modernized platforms and the use of cloud based solutions to support its digital business transformation and business automation where is deemed cost effective, allowing IT staff to concentrate on delivering of services. It is imperative to say that Cloud IT risks shall be assessed and clearly mitigated.

The key strategic themes and objectives that will drive the IT strategy to meet the business goals and objectives are stated below.

Themes (Goal)	1. Increase the delivery of business solutions to automate and optimize core business processes.	2. Improve the management of information to turn data into powerful insights and information into knowledge that will provide better decision making.	3. Improve operational excellence by providing a high performing and resilient IT environment.

Objectives (Initiatives)	***Drive digital transformation by:*** • Automating the Operations Life Cycle • Improving the financial management of operations and strategic budget systems • Modernizing the HR processes and improve human resources management • Increase communication and interaction with customers and the public	***Get insights from the data and information by:*** • Capitalizing on Information capture/creation, delivery, usage, and management • Leveraging data analytics and consolidated reporting throughout the organization to drive better insights and deliver value to business • Building a knowledge and learning organization • Manage data and information in a structured way	***Build a flexible IT Operating Model by:*** • Adapting a modern and agile IT Architecture • Providing the appropriate IT structure, staffing, and sourcing • Improving IT skillset and competences • Managing and developing projects in an efficient and effective way • Achieving a high level of partnership and alignment with business
Expected Business Outcomes	Customer responsiveness Business benefits realization	Fast and accurate decision making Managed Risks (risk optimization) Organizational effectiveness	Performance Management Resources optimization User Satisfaction

Concluding, the IT strategy entails a gap analysis of the current IT state against the desired future one so as to identify areas for improvement and formulate an IT Strategic Plan comprised of robust IT initiatives and determining the appropriate level of IT resources (people, processes, technology, financial) needed to be able to reach the desired state. This will require the development of a detailed IT strategy implementation masterplan, which will provide specific actions for the execution of the IT strategic objectives. The IT action plan for the implementation of the IT strategy will be presented for approval by the BoD.

8.2 HR Strategy

To a great extent success is determined by the quality of institutional and human relations inside the Bank. Therefore, significant attention has to be given to the establishment of an environment characterized by trust, high morale and dialogue.

By integrating human resources management (HRM) into the organization's planning process, and emphasizing HR activities that support broad mission goals, BSTDB will ensure that the management of human resources contributes to the achievement of its medium-term strategic goals. This is particularly important regarding the organizational Performance Management System (PMS), pushing all Departments toward achieving defined organizational strategic goals and measuring progress toward those goals.

To this end, at a minimum, the following should be emphasized:

- Recruitment and promotion of staff should be based on merit;
- Recognition of the need for continuous learning from own and external experiences;
- Provision of clear career path for staff and adoption of a human resource development policy;
- Recognition of the role of support units and equal treatment of staff (one staff class);
- Respect and observance of standards, policies, rules and regulations by all staff;
- Well defined incentive structure to reward achievements, motivation and dedication;
- Clear definition of tasks, responsibilities and related authority;

- Resistance to opportunistic approaches and maintenance of clear and uniform performance standards and evaluation processes.

Furthermore, over the MTSBP period, the HR Department will take into consideration and take the necessary action aiming at:

- Regularization of the existing individual service providers in compliance with the Bank's Recruitment and Appointment Policy, and continued use of full-fledged employment and the concept of temporary positions for the filling of temporary personnel gaps.
- Modification of the existing Bank's Performance Management Policy with increased emphasis on Departmental Key Performance Indicators (KPIs) as a direct and measurable link between individual performance and the performance of the institution.
- Perfecting the existing tools for management of unsatisfactory performance with the purpose of establishing an optimal balance between managerial flexibility in the interests of the institution and the basic rights of the employees.
- Moving away from the "broadbanding" position classification system to a system providing finer granularity and a more structured approach towards recruitment and career development decisions.
- Implementing basic salary reviews for the staff of the Bank for better competitiveness in the labor market and increasing the quality of recruited human capital.
- Continued movement of various critical HR processes to the SAP platform (personnel management, leave administration, recruitment, payroll administration, performance management, etc.)

9 Accountability and Enterprise Risk Management

9.1 Independent Accountability Mechanism

The Bank will continue enhancing its Independent Accountability Mechanism, during the 2019-2022 period, to ensure that it remains in line with best practices. The "Procedure for the Receipt, Retention and Treatment of Complaints" will be reviewed and updated, as appropriate, in order to reflect evolving best practices and trends in IFIs. More specifically, among other policy options, the establishment of ad-hoc independent panels of experts and methods for possible mediation between project owners and complainants will be examined. Furthermore, the possibility of undergoing a public consultation process during the review/ update process will be explored, with an aim to enhance transparency and improve engagement of all key stakeholders (citizens, community groups, peer institutions).

Furthermore the Bank shall continue to play an active role in the IFIs' Independent Accountability Mechanisms Group, as appropriate, in order to identify current accountability trends, good practices and knowledge, exchange views, share experiences, contribute in supporting institutional capacity building of community of practice and explore the possibility of greater harmonization among IFIs' Accountability/Complaints mechanisms.

For the 2019-2022 period, public/ outreach events shall be organized in Member States, either jointly with other IFIs or on a standalone basis, in order to raise awareness and co-operation among stakeholders. The objective of such events is to share information about independent accountability mechanisms (IAMs), exchange views with Civil Society Organizations on their experiences and listen to concerns, and discuss ideas from the participating organizations about promoting accountability and redressing harm.

9.2 Enterprise Risk Management

The Bank has established a functioning, consolidated, and on-going Enterprise Risk Management (ERM) 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.

The Bank's ERM mechanism shall be enhanced, as appropriate, during 2019-2022, based on the Bank's own experience to date and the recommendations of the external auditors and the Audit Committee, to capture and quantify (to the extent possible) the overall risk appetite and exposure of the Bank.

The Bank's ERM exercise is implemented following the COSO's 'Internal Control Integrated Framework' and 'Enterprise Risk Management' methodology, as a basis. The scope of the coverage and responsibilities of the Bank's ERM Working Group will be expanded to encompass all key risks of the organization, as appropriate.

10 Business Plan and Financial Forecast

10.1 Business Plan 2019-2022

Business Plan Context

The Medium Term Strategy and Business Plan (MTSBP) 2019-22 is the last such strategy covering the period of the Long-term Strategic Framework (LTSF) 2010-20, and will be the first to open the new LTSF 2021-30. Its preparation comes at a time in which the Black Sea Trade and Development Bank has completed 19 years of operation. During this period it has achieved a strong financial profile which is underpinned by factors such as conservative independent policies; strong capitalization; high liquidity; prudent approach to borrowing, provisioning and investing.

BSTDB's credit rating of A2 by Moody's and A minus by Standard and Poor's exceeds that of any other regionally based entity, and is approximately six notches higher than the weighted average credit rating of its shareholders. This has allowed the Bank to establish its credibility in a crowded and competitive operating environment.

On the business side, BSTDB has developed a banking loan portfolio of €1.14 billion at end 2017 (€1.17 billion if equity is added), with an overall balance sheet of €1.5 billion. By any standard, this is small relative to the financing requirements in the Region in order to promote economic development and regional cooperation effectively. In order to move towards achieving the vision stated in the LTSF 2010-20 that "BSTDB intends to be recognized … as one of the prominent development finance institutions for the Black Sea region… and would become a preferred partner in the region for clients…" the Bank needs to focus on growth of the portfolio and improvement of the quality of its portfolio. The Bank's business plan for 2019-2022 is developed on the basis of the Strategic Goals and Operational Strategy, with due attention paid to the constrains imposed by external and internal factors.

MTSBP 2019-2022 Base Case Scenario of Growth - Business Plan Target and Operational Considerations

An important threshold for BSTDB would be to increase its loan portfolio to €2.1 billion by 2022, while maintaining high portfolio quality. Relative to end 2017, this implies average annual loan portfolio growth of 12.2%, considerably higher than the 8.0% average annual growth achieved since 2009.

This outcome would achieve a ratio of roughly 1:2 of own capital to borrowed funds, an indicator of mobilization that is symbolically significant. Such growth supported by more regular issuance would help to enhance further BSTDB's profile with investors and ensure that the Bank can access markets when it needs to, at sufficiently favorable rates which it can then transform into attractive lending for the benefit of its clients- the agencies, firms, and banks operating in the Black Sea Region.

A portfolio size of €2.1 billion in outstanding operations is the maximum figure that could be reached before serious discussion would be required about another capital increase through a new subscription of the available authorized capital. Beyond 2022, only one to two years' worth of additional activity at similar rates of growth may be feasible before reaching the operational gearing ratio limit. This scenario may be called the Growth Case and should be regarded as the Base Case.

Maintenance of quality with such growth would require that public sector lending (including sovereign guaranteed projects and municipal finance) would need to expand greatly, up to approximately €700 million by end 2022. This, in turn, will require a pricing approach that is in line with the market for such operations.

Borrowing requirements and funding program for the Base Case Scenario of Growth

If the portfolio achieves the projected 12.2% growth each year this will translate into borrowing requirements of approximately:

This translates into annual borrowing requirements of:

2019	2020	2021	2022
€ 220 million	€ 210 million	€ 730 million	€ 260 million

These figures assume that none of the borrowings obtained in the earlier years mature in the later years. If we assume the current currency split of the loan portfolio (50% EUR, 40% USD, 10% other) continues, by 2022 the Bank will need around €350 million in Euro funding and €950 million equivalent in USD funding.

At end 2018, the Bank had around €200 million in loans from other development institutions. Given the willingness of these lenders to renew facilities and the possibility of additional facilities, we would anticipate €250 – 300 million of BSTDB financing to come from this source over the four year period. The Bank has a USD 500 million bond issue maturing in 2021.

Rather than wait until 2021 the Bank will consider a liability management exercise (in 2020) whereby we buy back the outstanding bond and issue a new five year USD bond. Even without the buy-back exercise the Bank may consider issuance in 2020 rather than wait until 2021. In addition to a USD bond issue the Bank may consider further Swiss Franc issuance – possible in 2019 to tie in with the CHF 100 million maturity. A Swiss Franc issue would likely be for around €200 million equivalent. The Bank has a Medium term Note Programme – which will enable it to take advantage of attractive issuance opportunities across a range of currencies (JPY, RON, EUR, CHF) and regions (strong interest from Far East Investors) , either for public deals or for private placements. Additionally, the Bank is able to issue short term commercial paper under its ECP programme and raise short term funds by 'repo-ing' its bond portfolio.

10.2 Main Concerns Looking Ahead

The Bank operates in volatile market conditions, and within a period of fluid and wide-ranging changes that have the potential to affect the international financial system and the international economic relations, with implications for the manner in which the Bank conducts business.

Global conditions may deteriorate as a result of intensified protectionist tendencies and competitive currency depreciation, subdued growth in global trade, increased unevenness of global economic growth, intensification of policy asymmetry among main economic powers, and protracted volatility of capital markets. Investors' perceptions of risk in emerging markets may deteriorate further with the resulting decline in both desire to hold debt instruments issued by emerging markets and to invest in emerging markets.

Furthermore, events specific to the Black Sea region, such as further increase in instability in adjacent regions, geopolitical considerations, or volatility in commodity prices may have a negative impact on the growth prospects of the region and on the perceptions of risk. As a consequence, credit markets may tighten, with limited availability of funds for BSTDB, irrespective of the cost of such funds. Such events would affect the ability of the Bank to access capital markets in an affordable and unfettered manner, and therefore would hamper its ability to implement the preferred Growth Scenario.

MTSBP 2019-2022 Business Plan - Alternative Scenarios

Maintaining Trend Scenario

If financial market conditions deteriorate rendering operations to grow the portfolio more difficult than projected, potentially accompanied by a mild deterioration in global and regional economic conditions, the Bank may revert to the Maintaining Trend Scenario and the Bank's portfolio may instead follow an annual growth path under which the outstanding portfolio would average eight percent per annum. Under such a scenario, the Bank's outstanding portfolio would increase to € 1.8 billion, and the Bank would need new funding of €1.1 billion. This translates into annual borrowing requirements of:

2019	2020	2021	2022
€ 160 million	€ 140 million	€ 640 million	€ 160 million

Low Case Scenario

An alternative fallback scenario, should global or regional conditions deteriorate significantly, or credit markets become restrictive to tap, may only permit average annual growth on the order of five percent per annum. The Bank considers such a 'Low Case' scenario as a lower bound, in which the portfolio at end 2022 grows to €1.6 billion. Such a scenario is considered for contingency planning and not targeted as an alternative under normal operating conditions.

10.3 Sensitivity Analysis

The Bank's results should not be sensitive to movements in exchange rates. Higher USD interest rates will negatively impact the return on the USD fixed rate bond portfolio. Higher EUR interest rates will benefit the return on the €750 – 800 million in capital but negatively impact the return on the Banks fixed rate EUR bonds.

Currently credit spreads are quite tight; BSTDB expected borrowing costs are currently LIBOR + 135 bps for 3 years; LIBOR + 170 bps for 5 years; nevertheless, in the future spreads are likely to widen due to both the effects of asymmetric monetary policy and to investor increased risk aversion with respect to developing and emerging markets.

10.4 Implementation and Monitoring

The Business Plan will be implemented through annual Budgets and performance will be monitored through periodic evaluation of KPIs and application of the Banks's Performance Management System. The MTSBP 2019-2022 wil be subject to a mid-term review, in 2020, at the time of completion of the current LTSF 2010-2020 and in anticipation of the formulation and submission for approval by the BoG of the new LTSF 2021-2030.

10.5 Financial Forecast 2019-2022

10.5.1 Base Case Scenario of Growth

The assumptions under which the Base Case Scenario of Growth was developed are the following:

- The outstanding portfolio will reach €2.1 billion, and the Balance Sheet size would amount to about €2.3 billion at end 2022.
- The portfolio of outstanding operations will grow over the period by about €800 million, representing an average annual growth rate of the outstanding portfolio of 12.2%.
- The average number of newly signed operations per banking team goes from slightly less than 4 in 2018 to 5 in 2022, and the average amount per team goes from €86 million in 2018 to €112 million in 2022.

- Average loan maturity of an operation at the time of signing increases from less than 4 years in 2018 to 5 years in 2022 (1 year availability and grace period, 4 years of repayment in equal installments).
- The Risk margin of the portfolio stays flat at 1.85% over the strategy period.
- Cost of borrowed funds will not rise over time due to the improvement in the Bank's portfolio quality, and the improvement in perception of the Bank as an established issuer.
- The Bank will sign every year new operations ranging from €300 million in 2019 to €560 million in 2022.
- The Treasury will continue to generate revenues but banking operations will remain the principal profit center in relative terms. The main concern of the Treasury will be to secure the funds necessary for Banking operations. In case of excess liquidity, the Treasury would seek profitable investments.
- Operating income will increase from an estimated €35.5 million in 2018 to reach a forecast high of €56 million in 2022.
- There are no actual write-offs and recoveries forecast for the period covered by the Business Plan.

Lending Margin Considerations

Current reserve and capital levels can maintain key financial ratios at healthy levels. The margin on Bank operations at end 2017 was about 3.80%. There are two possible portfolio growth scenarios regarding the evolution of the lending margin over the strategy period:

(i) Under a scenario in which the main focus is on financing high quality large size and long maturity operations that have low risk profile and therefore require very low levels of provisioning, the margin on non-sovereign operations is targeted at 3.50% and the margin on sovereign operations ranges from 1.25-1.50%. Under such scenario the overall minimum average margin for the Bank would remain above 2.75% at end 2022.

(ii) Under a portfolio structure at end 2022 more similar to the one existing at end 2017, optimal results will be obtained if the aggregate average margin at end 2022 will remain above 3.50%. Under such scenario, attention will be paid to the application of a more specific pricing for each asset class.

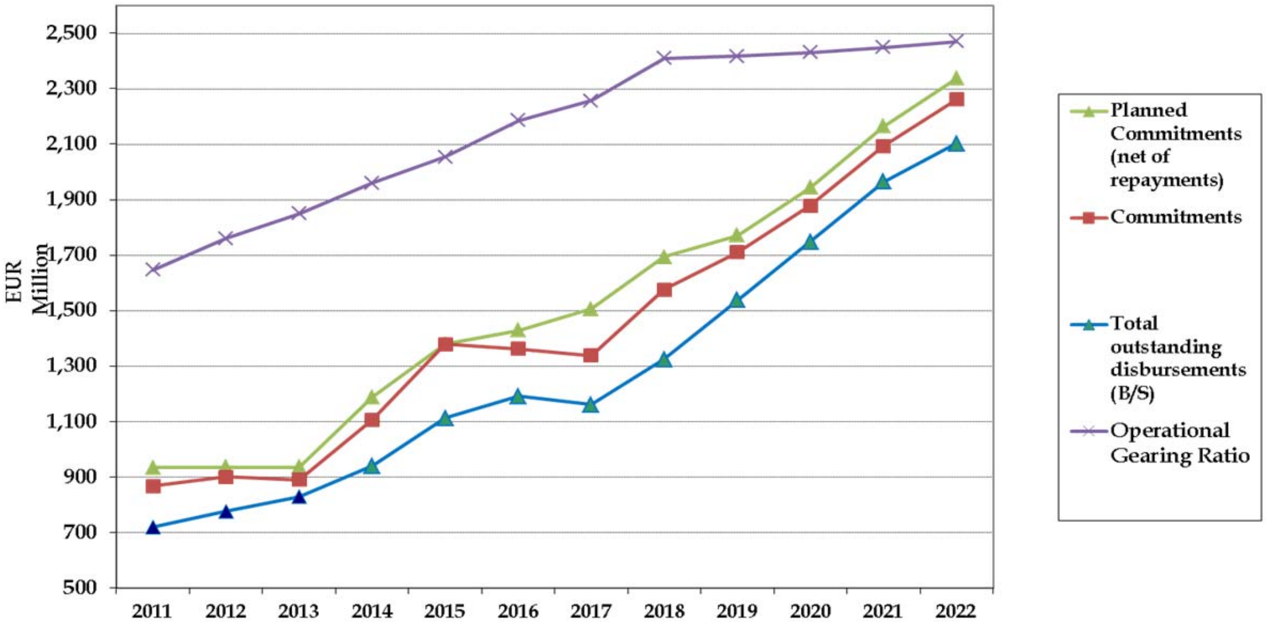
Table 6- Base Case Scenario of Growth- Forecast

INDICATORS EUR mil.	2018	2019	2020	2021	2022
Operating Assumptions					
Avg. Loan maturity	4.00	4.00	4.50	5.00	5.00
Amount per operation	22.00	22.00	22.00	22.00	22.00
Operational Expense Escalation Factor	1.00%	1.40%	1.25%	1.50%	2.00%
Depreciation (as % of prior years PP&A)	8.00%	8.00%	8.00%	8.00%	8.00%
Financial Assumptions					
Base Rate (return on liquid assets)	-0.15%	0.00%	0.10%	0.15%	0.30%
Average cost of funds	1.48%	1.49%	1.82%	1.87%	1.83%
Interest on loans	5.14%	5.19%	5.27%	5.27%	5.13%
Net Cash requirements	273	196	151	151	180
% of NCR	50%	50%	50%	50%	50%
Liquidity buffer	137	98	76	76	90
Extra liquidity	256	176	193	143	156
New commitments (signed)	**491**	**454**	**500**	**525**	**526**
New BoD approved	**517**	**568**	**571**	**600**	**601**
Disbursements	507	560	541	526	497
Reimbursement	343	347	332	310	358
Total outstanding disbursements (B/S)	**1,325**	**1,538**	**1,748**	**1,964**	**2,103**
Commitments	**1,576**	**1,711**	**1,879**	**2,094**	**2,262**
Planned Commitments (net of repayments)	**1,694**	**1,770**	**1,944**	**2,164**	**2,336**
Total signed undisbursed	251	172	131	130	159
BoD approved not signed	117	60	65	70	75
Operational Gearing Ratio	***2,409***	***2,416***	***2,431***	***2,448***	***2,470***
Institutional Gearing Ratio	***3,613***	***3,625***	***3,646***	***3,673***	***3,705***
Results					
Number of operations (Newly signed)	22	21	23	24	24
Operations per Banking team (newly signed)	4.5	4.1	4.5	4.8	4.8
Productivity volume (operation per banker)	1.06	0.98	1.08	1.14	1.14
Planning target (amount per Team)	**98.24**	**90.87**	**99.96**	**104.96**	**105.22**
Growth Rate in Active Portfolio (signed)	***14.91%***	***10.96%***	***9.53%***	***10.00%***	***8.76%***
Growth in gross Loans outstanding (B/S)	***14.80%***	***15.14%***	***13.63%***	***12.34%***	***7.08%***
Ratios					
Capital	807	815	829	846	868
ROAE	1.82%	1.22%	1.71%	2.12%	2.56%
ROAA	0.89%	0.57%	0.75%	0.87%	1.00%
Cost/Income Ratio (before provisioning)	56.76%	68.98%	43.10%	40.18%	38.71%
Equity/Total Assets	47.81%	45.98%	42.25%	40.07%	38.33%
Loan loss provisions/total loans (end of year)	3.11%	2.71%	3.26%	3.70%	4.10%
Revenues after opex/revenues before opex	19.52%	12.75%	31.11%	32.31%	32.43%

INCOME STATEMENT	2018	2019	2020	2021	2022
Interest and Similar Income					
Interest on loans	62.70	68.81	84.67	94.79	101.15
From placements with Financial Institutions	5.00	0.10	0.05	0.09	0.14
From Investment Securities	8.88	6.90	2.59	2.02	2.13
From front-end and Commitment fees	1.70	3.40	1.70	1.70	1.70
Total Interest and Similar Income	**78.28**	**79.21**	**89.00**	**98.60**	**105.13**
Interest Expenses and Similar Charges					
Interest Expenses	34.28	38.59	33.30	38.37	42.72
Other Charges	8.54	7.14	7.14	7.14	7.14
Issuance and Arrangement Costs	1.80	1.59	1.00	1.15	1.20
Total Interest Expenses and Charges	**44.61**	**47.32**	**41.43**	**46.65**	**51.05**
Net interest Income	**33.67**	**31.88**	**47.56**	**51.95**	**54.08**
Other Income					
Net Fees and Commissions	4.18	1.13	2.44	2.86	3.29
Net Income (Loss) on Forex	-1.12	0.00	0.00	0.00	0.00
Other Income	0.00	0.00	0.00	0.00	0.00
Total Other Income	**3.06**	**1.13**	**2.44**	**2.86**	**3.29**
Operating Income	**36.72**	**33.01**	**50.00**	**54.81**	**57.37**
Administrative Expenses					
Total salaries and benefits	15.50	16.41	14.89	15.19	15.19
Other administration expenses	4.87	5.86	4.82	4.89	4.99
Depreciation	**0.47**	**0.51**	**1.85**	**1.94**	**2.03**
Total Administrative Expenses	**20.85**	**22.77**	**21.55**	**22.02**	**22.21**
Income before provisions	**15.88**	**10.24**	**28.45**	**32.79**	**35.16**
Provisions	**1.66**	**0.34**	**14.37**	**14.99**	**13.21**
Net profit	**14.22**	**9.90**	**14.08**	**17.80**	**21.95**

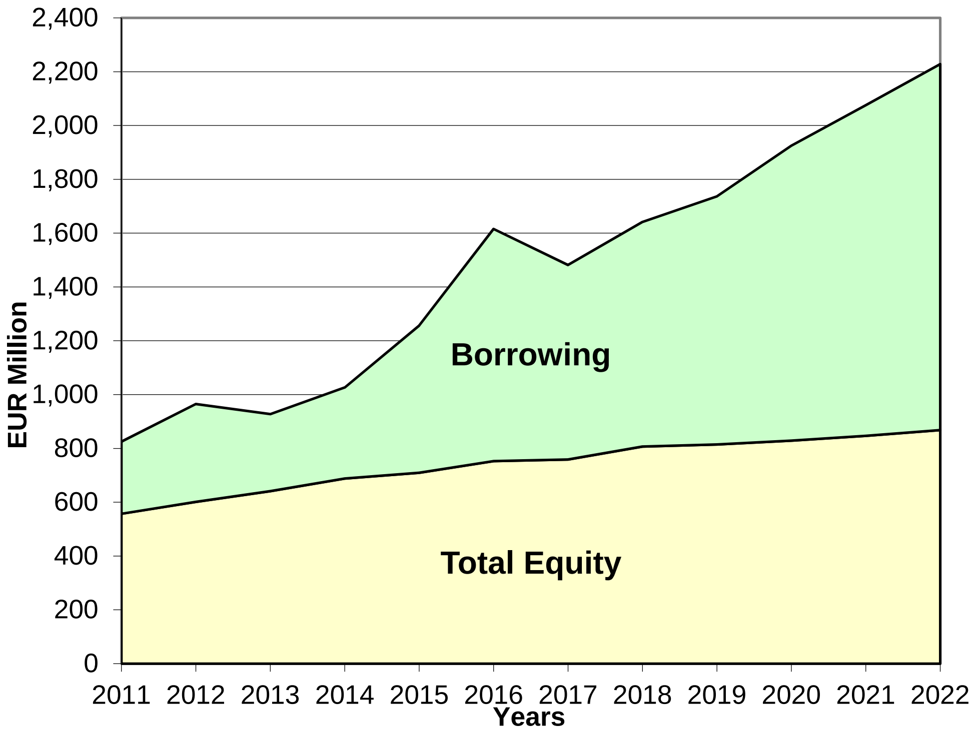
BALANCE SHEET	2018	2019	2020	2021	2022
Assets					
Cash and bank balances	75.80	78.60	50.00	50.00	50.00
Placements with financial institutions	3.59	1.92	88.22	35.62	60.01
Investment securities	288.70	169.00	100.00	100.00	100.00
Total deposits and securities/Liquidity	**368.09**	**249.52**	**238.22**	**185.62**	**210.01**
Derivative financial instruments	**1.12**	**1.40**	**0.00**	**0.00**	**0.00**
Less: provisions for impairment	0.28	0.28	0.28	0.28	0.28
Loans	1,309.49	1,513.02	1,698.64	1,901.88	2,041.13
Equity investments	26.52	25.30	49.43	61.98	61.73
Less: provisions for impairment	-40.69	-41.03	-55.39	-70.38	-83.60
Net loans and equity investments	**1,295.32**	**1,497.29**	**1,692.67**	**1,893.48**	**2,019.26**
Receivables and accrued interest	**21.21**	**19.54**	**22.52**	**26.22**	**30.10**
Paid-in share capital not received	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Less: deferred income	-8.50	-12.00	-7.50	-7.50	-7.50
Property, technology and equipment	3.45	3.73	4.01	4.30	4.58
Intangible assets	4.78	5.62	6.45	7.29	8.12
Less: accumulated depreciation	-6.82	-7.33	-9.18	-11.11	-13.14
Net property, technology and equipment	**1.41**	**2.02**	**1.29**	**0.47**	**-0.44**
Other assets	**9.28**	**13.88**	**13.88**	**13.88**	**13.88**
Total assets	**1,688**	**1,772**	**1,961**	**2,112**	**2,265**
Liabilities					
Borrowing	**834.71**	**921.91**	**1096.26**	**1229.05**	**1,359.75**
Payables and accrued interest	19.42	12.72	13.71	14.21	14.71
Deferred income/Other liabilities	0.00	0.00	0.00	0.00	0.00
Derivative financial instruments	26.84	22.50	22.50	22.50	22.50
Total liabilities	**880.97**	**957.13**	**1,132.48**	**1,265.76**	**1,396.97**
Paid-in share capital	**686.55**	**686.55**	**686.55**	**686.55**	**686.55**
General reserve	**30.00**	**35.02**	**35.02**	**35.02**	**35.02**
Surpluses	**90.45**	**92.95**	**107.03**	**124.83**	**146.77**
Total Equity	**806.99**	**814.52**	**828.60**	**846.40**	**868.34**
Total own funds and liabilities	**1,688**	**1,772**	**1,961**	**2,112**	**2,265**

Evolution of Active Portfolio to 2022



(Actual for 2011-2017, Estimated 2018, Projected for 2019-2022)

Borrowing and Capital Requirements



10.5.2 Maintaining Trend Scenario

The assumptions under which the contingent Maintaining Trend Scenario (TCS) was developed are consistent with a case where global conditions deteriorate as a result of intensified protectionist tendencies and competitive currency depreciation, subdued growth in global trade, increased unevenness of global economic growth, intensification of policy asymmetry among main economic powers, investors' perceptions of risk in emerging markets deteriorates with the resulting decline in both desire to hold debt instruments issued by emerging markets and to invest in emerging markets, and disruptions and protracted volatility of capital markets. Further, specific to the Black Sea region, further increase in instability in the adjacent region, geopolitical considerations, volatility in commodity prices may have a negative impact on the growth prospects of the region and on the perceptions of risk.

The main assumptions are the following:

- The outstanding portfolio will reach €1.8 billion, and the Balance Sheet size would amount to about €2 billion at end 2022.
- The portfolio of outstanding operations will grow over the period by about 35%, representing an average annual growth rate of the outstanding portfolio of 8%.
- The average number of newly signed operations per banking team goes from slightly less than 4 in 2018 to 4.5 in 2022, and the average amount per team goes from €86 million in 2018 to €100 million in 2022.
- Average loan maturity of an operation at the time of signing increases from less than 4 years in 2018 to 4.5 years in 2022 (1 year availability and grace period, 3.5 years of repayment in equal installments).
- Cost of borrowed funds remains flat over time in spite of the improvement in the Bank's portfolio quality, and likely overall average maturity of borrowed funds declines, with borrowing volumes uneven as the Bank would have to tap markets whenever appear windows of opportunity.
- The Bank will sign every year new operations ranging from €430 million in 2018 to €500 million in 2022 (not much lower than the Euro 550 envisaged under the HCS).
- The Treasury will continue to generate revenues but banking operations will remain the principal profit center in relative terms. The main concern of the Treasury will be to secure the funds necessary for Banking operations.
- Operating income will increase from an estimated €43.5 million in 2018 to reach a forecast maximum high of €60 million in 2022 (equal to the lower range level of the HCS). Net profit remains positive throughout the strategy period.
- Provisions are assumed to reflect the relationship between the Risk Margin and the portfolio quality, and are set to decline from 4.2% in 2018 to 3.7% in 2022. There are no actual write-offs and recoveries forecast for the period covered by the Business Plan.

Table 7- Maintaining Trend Scenario

Forecast – Operational Activity

INDICATORS	2019	2020	2021	2022
Financial Assumptions				
Base Rate (return on liquid assets)	0.00%	0.10%	0.15%	0.30%
Average cost of funds	1.56%	1.64%	1.69%	1.66%
Interest on loans	5.26%	5.09%	5.09%	5.01%
Net Cash requirements	172	177	182	184
% of NCR	50%	50%	50%	50%
Liquidity buffer	86	88	91	92
Extra liquidity	149	157	165	172
New commitments (signed)	**466**	**477**	**487**	**489**
New BoD approved	**532**	**545**	**556**	**559**
Disbursements	462	472	482	487
Reimbursement	336	356	357	372
Total outstanding disbursements (B/S)	**1,448**	**1,564**	**1,690**	**1,804**
Commitments	**1,599**	**1,720**	**1,850**	**1,967**
Planned Commitments (net of repayments)	**1,770**	**1,879**	**1,999**	**2,108**
Total signed undisbursed	151	156	161	163
BoD approved not signed	171	159	149	141
Operational Gearing Ratio	***2,426***	***2,446***	***2,468***	***2,490***
Institutional Gearing Ratio	***3,640***	***3,670***	***3,702***	***3,735***
Results				
Number of operations (Newly signed)	21	22	22	22
Operations per Banking team (newly signed)	4.2	4.3	4.4	4.4
Productivity volume (operation per banker)	1.01	1.03	1.05	1.06
Planning target (amount per Team)	**93.11**	**95.44**	**97.35**	**97.83**
Growth Rate in Active Portfolio (signed)	***11.64%***	***8.99%***	***9.14%***	***8.08%***
Growth in gross Loans outstanding (B/S)	***9.48%***	***8.02%***	***8.03%***	***6.76%***
Ratios				
Capital	825	844	866	888
ROAE	2.32%	2.39%	2.49%	2.53%
ROAA	1.14%	1.18%	1.17%	1.15%
Cost/Income Ratio (before provisioning)	48.32%	47.96%	47.66%	47.47%
Equity/Total Assets	50.70%	48.29%	46.03%	44.40%
Loan loss provisions/total loans (end of year)	4.05%	4.04%	3.99%	3.96%
Revenues after opex/revenues before opex	30.94%	30.02%	29.50%	28.91%

11 Action Plan for Strategy Execution

11.1 Translating Strategic Goals into Measurable Targets

Objectives

The principal objectives of the MTSBP are to make steady and measurable progress in the following:

- meet shareholder expectations and provide client satisfaction;
- maintain financial stability and improve operational effectiveness (asset quality, cost control, productivity, profitability);
- achieve institutional consolidation and process optimization; and
- establish and maintain a work environment conducive to attracting, motivating and retaining high quality staff with the required skills and attitude.

Goals

The Bank's growth and performance objectives are designed to achieve adequate financial protection and the mix and structure of debt and equity envisaged by the Financial Strategy, while seeking to minimize the cost of employed capital.

Target

The target of achieving an outstanding portfolio size of Euro 2.1 billion by end 2022:

- Ensures manageable growth;
- Provides an ideal balance between own capital and borrowed funds;
- Provides for constant growth in reserves and surpluses;
- Requires a modest and reasonable increase in staff levels;
- Offers the flexibility to adjust in case of sudden changes in the operating environment.

Country Strategy Progress Indicator

An indicator of progress towards meeting strategic targets is the achievement of at least 80% of the operational activity targeted for each country in the forthcoming country strategies- with targeted measures to ameliorate a situation being undertaken in cases where there is a risk the Bank may not meet this objective. While the Bank is to a certain degree a demand oriented institution, it will devote additional resources and effort to countries- and possibly specific areas of need within countries- which are considered underserved.

11.2 Institutional Key Performance and Risk Indicators

In order to measure progress towards achieving strategic goals and meeting the targets, the Bank uses metrics consistent with its goals, which provide the opportunity to detect deviations and adopt corrective actions.

The Bank intends to use a limited set of Institutional, Divisional and Departmental KPIs which are linked to measurable goals and targets meaningful for the implementation of the MTSBP and for measuring both progress and performance in achieving the strategic goals stated in this document.

For the future, the Bank will evaluate and assess what alternatives are best suited to support adoption of a performance management system that works, without excluding the possibility of a 'mix and match' approach, if deemed appropriate.

11.2.1 Key Risk Indicators

The Bank decided to establish a monitoring system in relation to the management of operational risks. One of the main processes for such management includes the development of Key Risk Indicators (KRIs), where appropriate, to act as early warnings of increased risk of potential losses. Effective tracking of these indicators shall allow the Bank to identify changing risks upon their occurrence and respond to them promptly. The KRIs complement KPIs in contributing to an organization's growth and success and relate to the key business objectives too.

The Key Risk Indicators are those threshold values of the KPIs which indicate entry into the danger zone where achievement of strategic goals becomes doubtful.

11.3 Operational Action Plan

The MTSBP 2019-2022 consists of two relatively distinct periods:

- the first covers the period of up to mid-term review which coincides with the completion of the Long-term Strategy 2011-2020, and
- the second covers the first two years of the new Long-term Strategy 2021-2030

It thus serves as a bridge between a Long-term Strategy focused on consolidation and a new Long-term Strategy aimed at growth, and providing thus both integration and continuity for the Bank's strategic planning and execution.

Overall Considerations

The effort to achieve higher relevance via rapid portfolio growth – involving operations of larger amounts and longer maturities, with potentially greater complexity and longer preparation periods – requires strengthening:

(i) quality at entry – strictly follow rules, deadlines, operational and financial guidelines for appraisal and due diligence,
(ii) develop institutional expertise and technical capability,
(iii) procurement rules, and
(iv) supervision and monitoring, functions connected with (a) active project portfolio management, and (b) NPL management and resolution.

Such an approach will permit the Bank to act proactively in order to fulfill to the best of its abilities the functions stated in the Agreement Establishing BSTDB.

For greater relevance to be achieved, it is essential that the Bank maintain and enhance institutional credibility, to the extent possible. To this end, the Bank is dedicated to adopt best practices and attain appropriate levels of checks and balances that (i) ensure compliance with existing internal regulatory framework, and (ii) enhance responsibility and accuracy without compromising efficiency and effectiveness. Consequent to the above, the present Operational Action Plan covers the period 2019-2020 and concentrates on activities as outlined below.

Public Sector Operations

- The Bank will seek opportunities to increase the share of sovereign and non-sovereign public sector operations. This has proven a particularly difficult challenge for BSTDB, and has resulted in much effort to increase pricing flexibility and define public sector activity more clearly. These represent ongoing efforts, and pricing flexibility will be examined further.
- The Bank will allocate additional resources and marketing efforts, and expand provision of instruments with new features, such as Municipal Finance Facilities and loans directly to Sovereigns or their specialized agencies for implementation of specific projects, with a clear understanding of uses of proceeds and of developmental impact per the purposes of the Bank, and depending upon the Bank's internal capacity for origination and monitoring capability. This will also require involvement on the part of Member States to facilitate the Bank's marketing efforts, and where necessary to help 'open doors' for Bank participation in such high mandate initiatives.
- Non-sovereign guaranteed operations in the public sector may reach up to 2 SOLs (per section 6.6), with sovereign guaranteed operations only limited by the country exposure limit.

Private Sector Operations

- Notwithstanding the imperative to increase public sector activities, the Bank's principal clientele will remain private firms and financial institutions active in the Black Sea region. This will include both well-established companies and medium-sized and 'second tier' firms- companies with high growth potential and/ or located outside of capital cities or principal financial centers, and which therefore often encounter difficulties in accessing financing and risk mitigation products.

- The main driver of the Bank in this area will be facilitation of access to finance for companies facing a financing gap not fulfilled by commercial banks and other private financiers.

Trade Finance Operations

- TF operations shall be provided primarily through specialized public sector institutions and agencies, in addition to financial institutions with extensive experience and volume of activity in the field.
- Credit lines will be the preferred instrument for the provision of trade finance for smaller sized transactions (pre-export finance, import finance, etc.), provided that there are adequate safeguards and documentation indicating Bank financing is used for the intended purposes. In Member countries with Export/Import banks (or related institutions) special efforts will be made to work with such "Exim" focused institutions. In countries which lack "Exim" institutions, BSTDB may seek to fill such a gap and play their role for the benefit of local exporters.
- Secondarily, the Bank will undertake research and feasibility studies in the member countries to determine the size and sustainability of demand for direct TF transactions, the client base, product line, volume and frequency of transactions. On this basis it shall assess and determine the cost-effectiveness of establishing a Trade Finance line of business.

Project Finance and Co-financing

- Target mobilization of domestic and foreign resources into the region. BSTDB will promote various means of resource mobilization such as a greater degree of co-financing, in the first instance with Observer institutions- in order to help strengthen relationships further- but also with additional financing partners with an interest in the Black Sea Region, whether in the public or private realm, as well as IFIs. This would imply engaging to a greater extent in syndications for project finance operations. To this end, in order to become more involved in such activities, the Bank will:
  - Establish a Co-financing Team within the Banking Division which will benefit of a higher SOL of 10% for private sector which may cover up to 50% of project cost, and of an SOL of 20% for public sector, which may cover up to 70% of project cost, but exposure may not be higher than €120 million per participation.
  - Initially the Bank shall continue to rely on lead arrangers, consultants, agents and other third party providers of services, but subsequently shall assess its internal capacity to acquire technical skills and develop systems, procedures and controls to allow it to assume lead arranging role in appropriately sized transactions.

Special and Technical Assistance Funds

- An additional area of potential in which the Bank's activity has been limited over the years is that of the development of Special Funds for co-financing, regional promotion, and/ or technical assistance services. Bank capacity and expertise in this area remains limited, but it represents an opportunity for development of closer links with Observers and new actors interested in the Region.

Business Model Adjustment

- The Bank may adjust its business model as it seeks to enhance its business profile, in order to facilitate achievement of its operational strategic goals.

- In order to contain the risk implications of a business model change, necessary precautions will be considered with respect to:
  - having in place procedures and platforms necessary for the successful appraisal, execution and control of transactions,
  - ensuring that all the required technical conditions are in place (access to local banks, local custody bank accounts, SAP system customized to be able to capture the transaction, proper reporting of the transaction ,etc.), and
  - securing staff with the relevant professional knowledge for the products that they are transacting.

Business Strength and Rating Action

- For the period 2019-22 the Bank would seek at a minimum to maintain its current credit ratings from Moody's and Standard & Poor's, and more ambitiously will continue to strive for an upgrade of one notch.
- Reduce funding costs to be in line with other issuers of the same credit rating, while focusing on diversification of sources of funding, regular access to markets in order to establish benchmarks and enhanced outreach and 'selling' of the Bank by sustaining investor relations and increasing familiarity of BSTDB.

The Operational Action Plan will be reviewed and updated in the context of the mid-term review of the Medium-term Strategy and Business Plan. If necessary, due to new shocks or rapidly changing regional conditions, additional modifications and/or updates may be considered, as required.

11.4 Institutional Action Plan

In implementing the Operational Action Plan, and in order for BSTDB to adequately respond to the needs and demands of its "shareholder-clients", special attention shall be paid to the following institutional issues, and improvements shall be made in the respective areas according to the proposed measures:

i. Automation and IT support

Transparency and reporting channels should be upgraded for real time provision of project information and identification of key controls during preparation and execution. The digital business transformation and insight to data and information will require a modernized platform approach that supports automation, predictive analytics, and information governance, especially through a centralized, consolidated, and integrated IT architecture. New IT software may assist and improve operational efficiency. The IT structure and personnel needs shall be in place to be able to deliver the IT strategic goals and objectives. The IT Strategy shall be reviewed annually to make sure that is aligned with the MTSBP 2019-2022, goals and objectives and any changes which may occur during the year shall be reflected in the IT action plan for IT Strategy implementation

ii. High Level MIS

Establish a high level MIS function with clear definition of responsibilities, separated from financial reporting. The function shall provide all management and portfolio of operations required reports in a timely manner and adequate quality to the appropriate levels of decision making authority.

iii. Comprehensive ALM

Review ALM policies and practices with a view to provide ALCO with the necessary tools for effective decision making, and the Management with timely, relevant and detailed information. If necessary develop a stand-alone ALM Policy.

iv. High Quality Portfolio

Secure greater quality at entry for operations by enhancing role of key support and review units as regards key financial and operating risks.

- Reduce preparation costs by making key conceptual decisions at an earlier stage so as to avoid undertaking work which is then cancelled out;
- Enhance NPLs work-outs and reductions, where feasible and appropriate, by judicious application of strategies tailored to the requirements of each specific case, and potentially involving restructuring, the sale of assets, and/ or write-offs.

To this end, the Bank shall ensure stronger coordination of appraisal, due diligence, supervision and monitoring activities with an integrated risk management function.

v. Marketing and Business Generation

The Banking Division will remain the core “production” center of the Bank, where most of the revenues are generated through preparation and implementation of project finance, corporate and trade finance operations. Emphasis will be given to building a pipeline of operations consistent with country/ regional needs and institutional objectives and to strengthening the capacity to respond to emerging opportunities. Promotional activities will be carried out to increase the Bank’s market presence and strengthen its role in satisfying its specific niche. Such activities will be supported by the following communications activities:

- Roadshows, corporate Business Generation events and presentations;
- Participations in third party business events, including conferences, sponsorships of exhibitions and related events, etc.;
- Promotional campaigns in international and national media (interviews, articles, corporate statements, etc.);
- Communication programs and targeted initiatives for Observers and prospective shareholders;
- Active promotion of the region and the Bank (and its services) through the corporate website and publications.

vi. Investor base development

The Bank will need to introduce itself to a wider range of international investors. Targeted investor groups might include Emerging Market Funds, Sovereign wealth funds, General Funds, Central Banks, Development banks, and Commercial Banks. The Bank will explore possibilities for issuance of foreign exchange denominated debt instruments in those Member States where it will be allowed to do so.

vii. Effective Human Resource Management

The human resources management activities planned for 2019-2020 aim to (i) attract and retain the right people, in the right job, with the right motivation, skills and training; and (ii) create an enabling work environment for staff to achieve their potential.

The achievement of the strategic goals over the MTSBP period 2019-2022 may require recruitment of additional front office staff, in particular for business generation, appraisal, structuring and supervision of project finance deals, public sector operations, and trade finance, in addition to marketing, investor relations, and procurement specialists. Additional professional staff will be required also in the middle and back offices, due to increased controls and increased disbursement activity.

The major components of the human resources program are:

(i) Creating a positive and enabling working environment that motivates staff;

(ii) Developing the capacity of staff members to reach their full potential, and assess the capacity needs (in terms of number of staff and qualifications) and making the necessary investments;

(iii) Facilitating turnover of staff with unsatisfactory performance;

(iv) Talent Sourcing, which refers to attracting and retaining talented people committed to the values of the organization, including by:

   a. Considering establishment of a Young Professionals Program for university graduates with limited prior work experience; and

   b. Pursuing an active recruitment program to establish a pool of suitable qualified and experienced personnel.

The Bank will base its decisions to retain, reward and promote staff on the basis of merit and performance.

viii. Enabling Organizational Structure

It is important for the Bank to be structured in a way that allows face the challenges ahead successfully, to respond effectively to evolving conditions, and to be both flexible and dynamic. Although the current organizational structure of the Bank is not a constraint on faster growth, certain adjustments may be needed, with special reference to the following:

- Provide for a cost effective and operationally efficient Organizational Structure that facilitates fulfillment of the mandate of the Bank, and which to the extent possible consolidates and clusters functions with closely related authority and responsibility, prevents conflict of interest in organization, and promotes open communication across divisional boundaries.
- The Bank shall be structured in Divisions established with a view to execute functions related to: (i) general advisory and overall control, (ii) front office, (iii) middle office, (iv) back office, and (v) administrative and general support services.
- The upgraded Organizational structure shall both economize on the use of human resources and make more effective use of available skills, in a way which would adequately cover, to the maximum extent possible, the evolving needs and core functions of a multilateral development institution with the regional cooperation and development mandate of BSTDB.

11.5 Strategy Map

In order to facilitate the strategy execution and provide the tools for integrating “what” the Bank wants to do to achieve the strategic target with “how”, the Bank uses the synoptic presentation of the Strategy Map.

BSTDB STRATEGY MAP

WHAT TO DO

Mission: To promote development and regional economic cooperation with a view to effectively contribute to the transition process of the Member States towards the economic prosperity of the people of the region.

Vision: To establish itself as a pre-eminent partner financial institution for the Black Sea region.

Operational Priority

Promote economic development

- Increase access to finance for small and medium sized companies
- Invest in sectors of real economy
- Provide finance for public sector infrastructure projects

Promote regional economic cooperation

- Support intra-regional trade
- Support intra-regional investment
- Expand financing of cross country operations and/or with cross-border benefits/neighborhood effects

Increase relevance for stakeholders

- Attract donor funds for Technical Assistance
- Increase Development Impact of Operations
- Increase cooperation with partner institutions

HOW TO ACHIEVE

Structure and Processes

- Lean organization structure, focused, efficient and effective
- Align structure with strategy, based on skills/needs
- Improved, simplified, effective systems and procedures
- Eliminate inefficiencies
- Enhance MIS
- Address challenges, Take opportunities

Finance and Portfolio

- Maintain A2 rating
- Maintain NPL below 5%
- Increase size of Portfolio to €2.1 bn
- Control spending
- Sustain income levels
- Focus on: (i) mandate fulfillment; (ii) operating efficiency; (iii) financial profitability
- Quality at Entry, effective risk management and supervision

Learning and Growth

- Corporate culture/ethics favoring high performance
- Employee loyalty, motivation, satisfaction
- Create a climate that supports innovation and change
- Effective performance and career management