2005
annual report

BSTDB: realizing regional potential

Black Sea Trade & Development Bank

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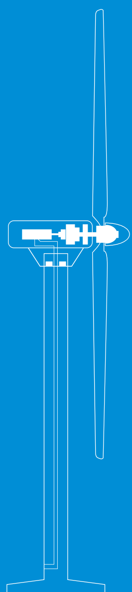

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Black Sea Trade & Development Bank

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As of 31 December 2005

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Board of Directors

As of 31 December 2005

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Ukraine	Director: **Mr. Valeriy Pyatnytskiy,** Deputy Minister of Economy Alternate Director: **Mr. Vitaliy Lisovenko,** Deputy Minister of Finance

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As of 31 December 2005

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Mr. Valeriy PYATNYTSKIY
BSTDB Director for Ukraine

Members:
Mr. Arthur JAVADYAN
BSTDB Director for the Republic of Armenia

Mr. Samir SHARIFOV
BSTDB Director for the Republic of Azerbaijan

Management

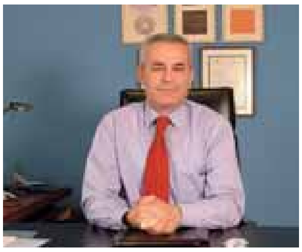
As of 31 December 2005

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

Mikhail Jernov
Vice President Banking

Valentina Siclovan
Vice President Operations

Plamen Petrov
Vice President Finance



Charalampos Tsarouchas
Secretary General

To the Board of Governors

In accordance with Article 35 of the Agreement Establishing the Black Sea Trade and Development Bank and Section 10 of its By-Laws, I submit to the Board of Governors the Bank's Annual Report 2005 as endorsed by the Board of Directors. The Seventh Annual Report also contains the Bank's financial statements, including a separate financial statement for the operations of its Special Fund, as prescribed in Section 12 of the Bank's By-Laws.

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

Statement by the President

As the processes of globalization and economic integration across the world continue to take root, international financial institutions established with the mission of providing development finance to serve as a medium for the promotion of cross-border investment and trade activity are poised to play increasingly important roles in shaping the framework of the international financial arena in the period ahead. Thanks to deepening regional cooperation and firmer intra-regional links, the Black Sea Region is advancing steadily along a firm trajectory leading to higher income levels, better living standards and a wider range of economic opportunities for all the countries and peoples of the Black Sea Region. In the seven years since its inception, the BSTDB, whose mission is to assist its Member States of the Black Sea Region in achieving sustainable economic growth, has become part of this framework.

During the course of 2005, the BSTDB's financing activities and its sectoral priorities in this respect remained closely determined by a concern to provide a high degree of economic development impact, while at the same time promoting intra-regional economic cooperation. Against this backdrop, BSTDB assigned explicit priority to financing proposals which were viewed as being of key relevance for the promotion and facilitation of economic cooperation within the Black Sea Region.

The growth in BSTDB's operations during 2005 reflects the concerted efforts spent by the management and staff to expand the Bank's portfolio of active operations, while at the same time carefully and uncompromisingly adhering to sound banking principles. Such efforts were assisted by a favorable global economic outlook, as well as by the improving economic fundamentals and evident progress recorded in most of the BSTDB shareholder countries, as regards deepening the financial sector further. BSTDB's efforts to assume a pro-active role in augmenting intra-regional financial flows have provided convincing evidence of its capability to generate value-added in an effective and market-friendly manner, while at the same time promoting economic development and furthering cooperation across the Region.

BSTDB's end-2005 financial results illustrate the rewards reaped from adherence to its policies and also reflect further consolidation of the Bank's reputable position in the international financial community. During the course of 2005, our total assets expanded by 22.9%. Meanwhile, borrowings utilized grew 6.4-fold, reflecting the increasing recognition and trust in the international financial community, vis-à-vis the BSTDB. Against the backdrop of these favorable developments in BSTDB's financial statements, operating income increased 40.9% year-on-year.

Controls on administrative costs, including depreciation, implemented throughout the year were mirrored in a 6.6% decline in total administrative expenses, relative to 2004. As a result of this financial discipline that was sustained throughout the year, a net income of SDR 3.4 million was achieved.

As the global economic outlook and the prospects of the Black Sea Region continue to improve, the BSTDB will be able to multiply its achievements. My conviction is based on our expertise on the Black Sea Region, on our unique stock of knowledge on the latter's needs and on the experience we have accumulated, with regard to efficiently meeting the market requirements of the Black Sea Region.

Our achievements to date will form the foundations of our future endeavors.

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

* Mr. Mustafa Gürtin accomplished his term in office as Chairman of the Board of Directors and President of BSTDB on February 15, 2006.

01

Highlights of 2005

BSTDB: realizing regional potential

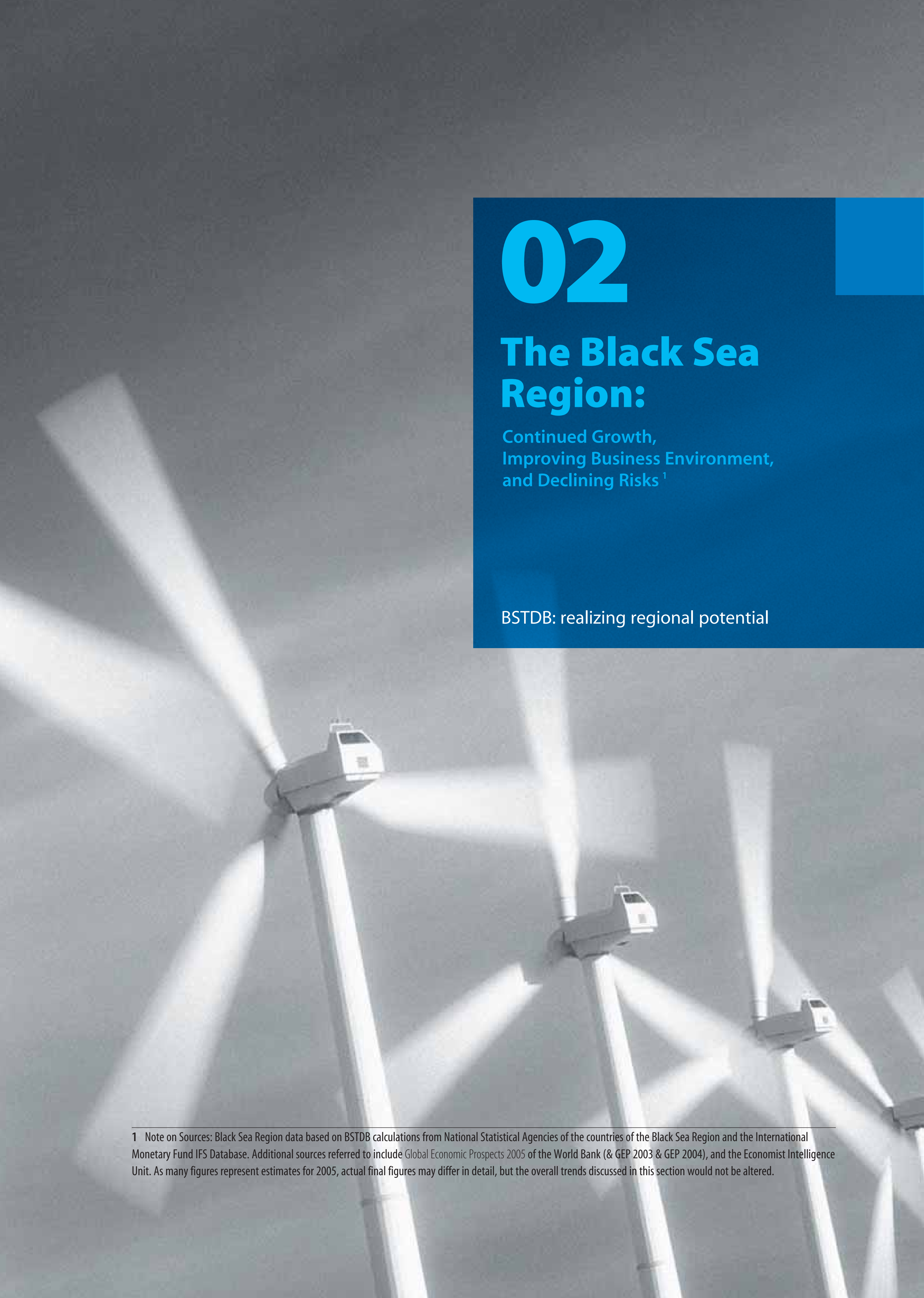
The Bank's active loan portfolio increased to SDR 469.8 million (appx. USD 671.5 million). Credit quality remained good, with only one project out of 59 demonstrating problems. The Bank realized a profit of SDR 3.4 million (appx. USD 4.8 million) during 2005, despite continued aggressive provisioning charges, one year ahead of expectations.

Signing and updating of two Memoranda of Understanding with the European Commission and major international financial institutions, which establish a framework for enhanced coordination and information sharing among participating parties, as well as cooperation in promoting development projects in BSTDB member countries, including under EU programs.

BSTDB held the Annual Meeting of its Board of Governors in Yerevan, Armenia. On this occasion, the Bank also hosted its traditional Black Sea Business Day in Yerevan attracting more than 250 officials, international investors, bankers and businessmen, as well as representatives of other IFIs. The event explored issues of investment potential of the Caucasus Region and the role of international financial institutions and also focused on SME and financial sectors development.

BSTDB's Baa2 credit rating was reconfirmed by Moody's during 2005, with due reference to the strength of BSTDB's capital structure, increasing international support, solid policies, good asset quality and high liquidity.

In 2005 the Board of Governors appointed Mr. Hayrettin Kaplan for the next presidential term ending in 2010 and decided that Russia will be the nominating country for the term ending in 2014. The Board of Directors also appointed Ms. Sophia Kassidova as Vice President Finance.



02

The Black Sea Region:

Continued Growth, Improving Business Environment, and Declining Risks [1]

BSTDB: realizing regional potential

1 Note on Sources: Black Sea Region data based on BSTDB calculations from National Statistical Agencies of the countries of the Black Sea Region and the International Monetary Fund IFS Database. Additional sources referred to include *Global Economic Prospects 2005* of the World Bank (& GEP 2003 & GEP 2004), and the Economist Intelligence Unit. As many figures represent estimates for 2005, actual final figures may differ in detail, but the overall trends discussed in this section would not be altered.

Economic Overview

Real GDP growth for the Black Sea Region- that is, the Member States comprising the Black Sea Trade and Development Bank- continued its strong trend of recent years, reaching 6.1%. Although this represents a slight slowdown relative to the exceptional years of 2003 and 2004, during which the Region grew at 6.5% and 7.5% respectively in real terms- it is indicative of a continued healthy expansion of economic activity throughout the Region and slightly above the average annual growth rate of 5.9% achieved since 2000.

The Black Sea Region's performance appears all the more notable when set in a global context and compared to the Region's key trading and investment partners in Central and Western Europe. For the European Union's 25 members (EU-25) as a whole experienced a decline in growth to 1.6%, while the performance of the 12 Eurozone member countries was even weaker, at 1.1%. The new EU Entrants from Central-Eastern Europe and the Baltics[2] fared somewhat better, achieving growth of 4.2%, but overall they too lagged behind the Black Sea Region.

2 Czech Republic, Hungary, Poland, Slovakia, Slovenia, and the Baltics: Estonia, Latvia, Lithuania.

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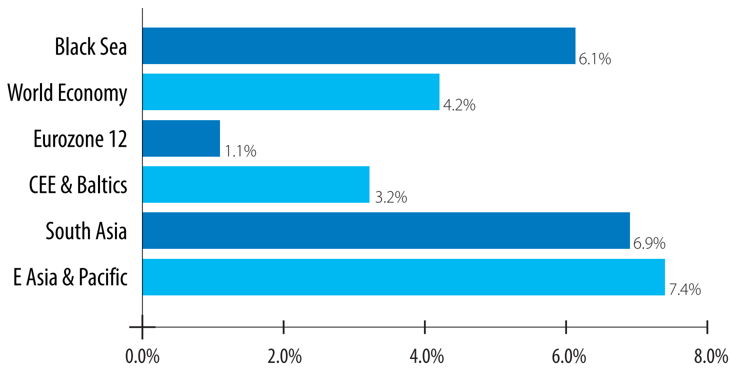
In comparison with the rest of the world economy, the Black Sea Region was outpaced only by the 7.4% average rate achieved by the developing countries of the East Asia and Pacific, and the 6.9% achieved by South Asia, two regions which benefited respectively from China's and India's impressive performances. See Figure 1.

Figure 1: Comparison of GDP Growth for 2005, by Select Region



This sustained growth has translated into rapidly growing income levels. Per capita incomes have increased across the board, with the regional average having more than doubled in five years in dollar terms, from roughly US$ 2,000 in 2000 to US$ 3,900 in 2004 and nearly over US$ 4,900 in 2005. This increase of 140% took place against a background of stable exchange rates vis a vis the dollar, meaning that it represents real increases in earnings and not merely a reflection of a weakening dollar. Indeed, even for 2005 relative to 2004, with the dollar depreciating by nearly four percent against the Region's currencies, per capita income levels increased by 20%. This trend is matched by data on average wage levels, with all countries (except Greece and Turkey) experiencing at least a doubling of average real wages- and in some cases even a tripling. While such figures have their limitations in terms of calculation and underlying meaning, and though they cannot be maintained indefinitely, they do reflect a genuine rise in living standards throughout the Region. Other key indicators of living standards, such as health and education data, have shown improvements and poverty surveys have shown that absolute poverty rates are declining, in some cases dramatically.

The rise in income levels is in turn helping to fuel the growth, as private consumption has been the fastest growing contributor to GDP growth, ahead of government consumption and investment, private and public. In countries with high emigration levels, remittances have played an important role in bolstering private consumption.

Turning to sectors of origin, the consumption led growth has fueled growth in the services sector in general, and construction specifically. In this respect, all indications are that the service sector in 2005 continued its upward trend of recent years, during which the services sector continues steady growth as a share of the economy, while agriculture shrinks and industry is either static, or in gradual decline. At present, services account for over 60% of GDP formation in the Region and continue to grow. Service industries generate most new employment growth, chiefly small and medium sized enterprises active in areas such as retailing, transport, tourism, health care, etc. The financial sector has also grown tremendously, playing an increasingly important intermediary function for the mobilization of financial resources for productive uses. Commercial bank lending has grown at double digit rates, to private businesses but even more so to consumer borrowers, as there has been an impressive increase in consumer oriented lending, including for mortgages. The consumption led growth has also affected construction positively. Rising income levels and the development of mortgages are the main reasons behind the continued construction boom taking place in all countries of the Black Sea Region.

Not coincidentally, the period of growth has coincided with the macroeconomic stabilization of the economies of the Region and the successful commitment to prudent fiscal and monetary policies. In addition to growth rates, other macroeconomic measures have also been favorable. Fiscal deficits have maintained a declining trend, and for 2005 the Region's overall fiscal balance was in surplus at +2.5% of GDP. Even if one removes Russia's exceptional surpluses for the last couple of years, the declining trend is still observed and for 2005 the regional deficit drops to approximately –2.2% of GDP, a figure less than half the deficit levels of a few years back. Public external debt levels have displayed even sharper declines, dropping from an average of 35% of GDP in 2000 to approximately 12% for 2005. Overall government debt levels have changed less dramatically, but they have also followed a downward trend, and as interest rates throughout the Region have declined, debt servicing has become less onerous for the economies. Indeed, the growing strength of the Region's economies is evidenced by the conversion of external debt to domestic debt undertaken by certain countries, an activity which would not have been possible without the growing confidence of investors in the Region, including many outsiders.

Table 1 presents a country by country breakdown of estimated outturns for 2005 of the following key economic indicators: real GDP growth, average annual rate of consumer price inflation, the balance of the consolidated government budget as a share of GDP, and the current account deficit as a share of GDP.

in the Region during the 1990s. In addition, due to their small size and geographic location, they have suffered disproportionately greater perceptional problems in terms of their perceived prospects and risks, as they are viewed as less diversified than larger economies and also more vulnerable to adverse events. However, they have been the

Table 1: Summary of Key Economic Indicators for 2005, by BSTDB Member Country

	GDP Growth	Avg. Inflation	Budget / GDP	Cur Acct Bal / GDP
Albania	6.0%	3.0%	-4.7%	-5.4%
Armenia	13.9%	0.6%	-1.1%	-2.3%
Azerbaijan	26.4%	9.6%	0.6%	-5.2%
Bulgaria	5.5%	5.0%	3.1%	-11.8%
Georgia	8.0%	7.0%	-3.0%	-8.9%
Greece	3.7%	3.5%	-4.1%	-6.5%
Moldova	7.1%	11.9%	2.1%	-7.3%
Romania	4.1%	9.0%	-0.8%	-7.8%
Russia	6.4%	12.7%	7.7%	11.0%
Turkey	7.4%	8.2%	-2.0%	-6.3%
Ukraine	2.6%	13.5%	-1.8%	3.1%

The figures confirm the positive results country by country. Growth was positive in each and every country for the fourth consecutive year (since 2002). There was a wide variation in growth results, from a low of 2.6% in Ukraine and 3.7% in Greece to double digit growth in Armenia and Azerbaijan. For both Armenia and Azerbaijan, 2005 was the fourth consecutive year of double digit growth in real terms, with the latter posting an exceptional 24% growth on the strength of energy revenues growth. Energy transit revenues, combined with strong economic reforms, helped Georgia post its strong results, while Armenia benefited from strong domestic demand and rising investment in, and output from, the metallurgy, energy and machine-building sectors. Moldova and Albania also experienced healthy growth in line with trends of recent years, with the strong inflow of remittances and an expansion of bank credit helping to boost growth in the services sector and especially construction.

Collectively, these five countries represent the 'smaller' economies of the Black Sea Region- countries which generally underwent the most trying initial periods of 'transition' from centrally planned economies to market oriented economies, and experienced setbacks from political and economic crises

fastest growing countries in the Black Sea Region in recent years, and their average growth rate of 14.7% for 2005 was more than double the overall regional growth rate of 6.1%. The average annual growth rate of these countries since 2000 has been 9.2%, ahead of the Region's 5.9% annual average during this period, and though they remain among the poorest BSEC members with a GDP per capita less than half the regional average, a measure of convergence has been achieved in recent years.

Turning to the 'larger' economies of the Region, while they experienced rates of growth on par or slightly lower relative to the performance of recent years, the rates remained robust for the most part. The two biggest economies, Turkey and Russia, maintained growth above 6% for 2005.

For Turkey, growth remained healthy albeit somewhat lower than the 8.9% growth in 2004, which in fact created a higher base to begin from. Notably, it was achieved in a context of extensive and far reaching political and economic reforms, the latter both structural (privatization, etc.) and fiscal/ monetary- with budget deficits being reduced to their lowest levels in recent history while the overall government

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debt was reduced and inflation was brought to single digit levels for the first time in decades. Most importantly, Turkey officially launched EU accession negotiations in October 2005. Russia also enjoyed continued healthy growth, driven mainly by private consumption that was buoyed by a large rise in real incomes, but also by increasing investment. Exports grew on the strength of high energy prices, and the current account surplus exceeded 10% of GDP. Energy receipts also helped boost the government budget surplus to over 7% of GDP, despite large spending increases in key sectors and the depositing of receipts into the Stabilization Fund, which reached record levels.

Bulgaria matched the strong growth of 2004 with private consumption, fueled by real wage growth and dynamic credit expansion, and investment leading the way. Gross fixed investment grew at an estimated 15% in 2005, and Bulgaria attracted high levels of foreign investment. Romania, for its part, experienced a greater moderation of growth relative to 2004, in large part due extensive flooding which hurt agricultural production and set back public investment projects. However other core activities remained strong- private consumption was very high and private investment, including inflows of foreign direct investment, maintained pace. More importantly, however, both countries continued on track with the EU accession process, with a view to becoming full members in 2007.

The Black Sea Region's 'slowest' performers, Greece and Ukraine, could only be deemed laggards if viewed in a strictly comparative regional context. For Greece's 3.7% was among the highest rates of growth achieved among the 12 Eurozone countries, and approximately three times higher than the Eurozone average of 1.1% achieved collectively for 2005. A result all the more impressive in view of its having occurred in the immediate post-Olympics year, a period during which other Olympics organizing countries have been beset by the 'hangover' of economic slowdown caused by declining public investment and the need for fiscal consolidation. The Greek economy experienced these difficulties to a degree, but they were more than offset by a boom in tourism, and continued healthy growth in shipping receipts, financial services, and private construction. As for Ukraine, the 2.6% growth came on the heels of an exceptional year in 2004, which set a high base rate, and it also masks important political and economic reforms which took place during 2005. Despite the difficulties experienced, Ukraine still managed to achieve record levels of exports and to sustain the sizeable current account surpluses (over 3% of GDP) which have appreciably improved its external position. Significantly, Ukraine also successfully carried out the flagship re-privatization of the Kryvorizhstal steel mill, obtaining a US$ 4.8 billion, that was twice the expected level of the re-privatization and six times the original price. The symbolic value of this successful re-privatization was large and it helped signify a positive change in the business climate for Ukraine, which improved its scores in various ratings of governance, business environment, and investment attractiveness (see below).

Business Environment and Country Risks

This in turn, reflects the improvements in specific measures of the business environment in the Black Sea Region, and more generally in the degree and extent of country risk observed. Country risk is a nebulous concept in that it is difficult to measure directly, and generally represents the weighted sum of a collection of ratings and scorings covering a broad range of issues, including (i) macroeconomic performance and stability, (ii) security, political and social stability, (iii) perceptions of public and private governance including implementation capacity, transparency, and corruption, (iv) quality and clarity of a country's legal and tax frameworks and the quality of the implementation thereof, (v) and overall the ability of economic entities to operate smoothly. In a business context, country risk refers to the likelihood that a non-business event will occur, or a non-business related situation will transpire, which may threaten (a) normal operation of the company (b) the value of assets, and/or (c) the profitability of loans and investments.

While there are many different measures, and any set of weightings carries elements of subjectivity which are open to debate, country risk scores for Black Sea Region countries continued their improvement during 2005 irrespective of the approach and/ or focus selected. Significantly, they have also shown a degree of convergence towards those of other countries generally deemed 'less risky' or 'low risk' such as the 25 EU member countries or most OECD countries.

Long term sovereign credit ratings, which represent confidence in the creditworthiness of countries, are one indication of these improving perceptions. Since these ratings incorporate elements of country risk within their calculation, albeit to differing degrees from one rating

agency to another, they nonetheless incorporate perceived measures of country risk to a certain extent. Table 1 contains the long term credit ratings provided by the three largest credit rating agencies globally, and it shows that five Member Countries obtained an upgrading in their credit rating during the course of 2005, including multiple upgrades in two specific instances (Romania with Moody's and Russia with S&P). One country received a downgrading while, significantly, another 'entered the market' and received its first sovereign rating, an indication of the progress of its economy. If anything, these ratings err on the side of being too conservative, as the economic fundamentals, the track record, and the growth prospects of the Region's economies arguably merit better scores. Nevertheless, four Member Countries currently possess 'investment grade' sovereign credit ratings, two others are drawing closer, and even outsiders perceive that the trend is in a favorable direction.

Corruption Perceptions Index[3]. Here too, while perception arguably lags behind reality, since Black Sea countries have undertaken far reaching, often difficult reforms in recent years to improve quality and transparency of governance, improvements are evident in the 2005 CPI relative to the 2004 CPI. Some Member Countries showed significant improvement in their absolute and relative scores compared with the previous survey and overall seven Member Countries showed progress in 2005 relative to 2004.

The EBRD Transition Report for 2005 showed general improvement in the business environment across most so-called transition countries[4], a label applicable to most BSEC Member Countries (except Greece and Turkey). Structural reforms in areas such as liberalizing the economy and expanding competition, banking reform, privatization, governance, enterprise restructuring, etc. were measured and four countries showed significant progress in structural reforms- Armenia, Georgia, Moldova, and Ukraine, while Azerbaijan, Bulgaria and Romania also exhibited progress. For key measures such as amount of time spent by firms dealing with public officials (a proxy for bureaucracy) and amounts paid in bribes (a proxy for corruption), most

Table 2: BSTDB Sovereign Credit Ratings Comparison December 2004 vs. December 2005

	December 2004			December 2005		
	Moody's	**S&P**	**Fitch**	**Moody's**	**S&P**	**Fitch**
Albania	—	—	—	—	—	—
Armenia	—	—	—	—	—	—
Azerbaijan	—	—	BB	—	—	BB
Bulgaria	Ba1	BBB-	BBB-	Ba1	BBB	BBB
Georgia	—	—	—	—	B+	—
Greece	A1	A	A+	A1	A	A
Moldova	Caa1	—	B-	Caa1	—	B-
Romania	Ba3	BB+	BBB-	Ba1	BBB-	BBB-
Russia	Baa3	BB+	BBB-	Baa2	BBB	BBB
Turkey	B1	BB-	B+	Ba3	BB-	BB-
Ukraine	B1	B+	B+	B1	BB-	BB-

Concerning governance and country risk, in recent years efforts have been made to measure quality of transparency and extent of corruption, with Transparency International perhaps the best known organization with its annual

3 See http://www.transparency.org/policy_and_research/surveys_indices/cpi. By definition, these indices are based on perceptions and are thus subjective. However, they do measure relative perceptions among countries, and perhaps more importantly, changes in perception in each country from year to year.

4 Quoted from EBRD Transition Report 2005, Office of the Chief Economist Presentation, November 2005. Transition countries are those engaged in a 'transition' from a centrally planned to a market oriented economy, with public sector ownership of assets usually declining, and the activity (and ownership share) of the private sector increasing.

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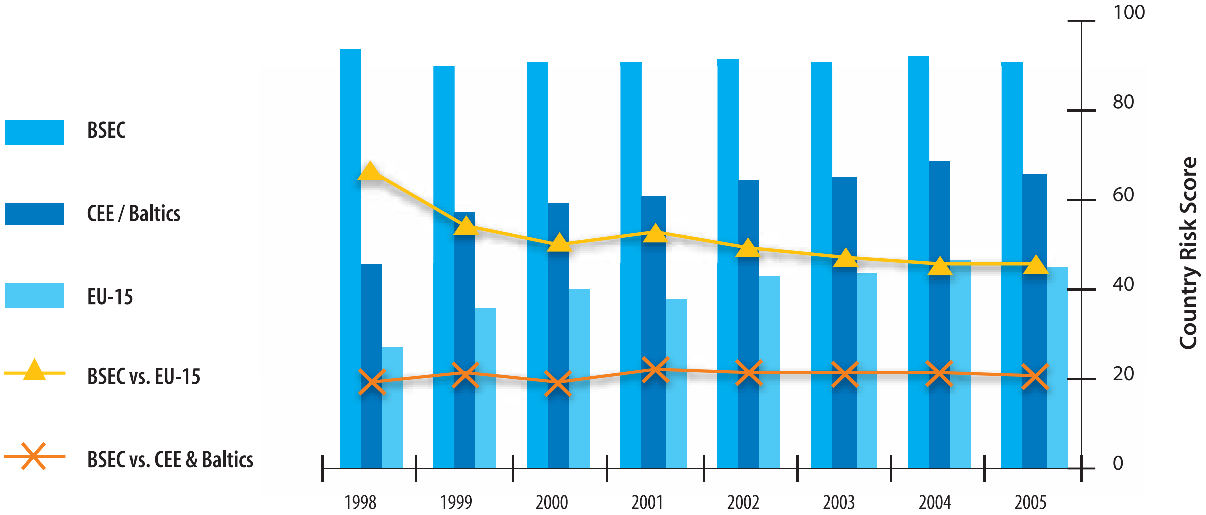
Member Countries showed progress in 2005 relative to 2002, with Georgia, Moldova and Romania in particular showing large improvements that leave them comparing favorably with other transition economies (including the 8 new EU entrants from Central Europe and the Baltics), and even with so-called 'mature' market economies (e.g. original EU-15 members) for certain measures.

On a longer time horizon, the Black Sea Region has improved (lowered) levels of country risk in recent years. More specifically, Euromoney magazine has one of the longest established and most frequently quoted/ referenced indices of country risk, which it publishes twice per annum. Figure 2 shows the evolution of country risk scores for the Black Sea Region, for the original EU-15 members, and for the eight new EU members from Central and Eastern Europe and the Baltics.

Here too, the trend in the BSEC Region has basically been one of improvement in recent years, with decreasing levels of country risk, both in absolute terms relative to previous years, and in comparison to the EU-15. While there remains a way to go before the Black Sea Region reaches EU-15 levels, the trend is encouraging. One interesting feature is that the countries of the Black Sea Region have maintained more or less the same difference in scores relative to the CEE & Baltics countries. In other words, the Black Sea Region has shown the same degree of improvement as the CEE & Baltics countries, even though it has enjoyed much less scope and opportunity to reap lower country risk benefits as a result of the EU accession process relative to the CEE & Baltics, given that only one Black Sea country is a member of the EU, two are expected to join in 2007, another is a candidate, and the remaining seven Member Countries are not candidates.

Ultimately, willingness to risk resources is one of the best measures of confidence- if not the best- of financial institutions and firms in the economy of a country. Like any indicator, it is not absolute, and may be driven by other

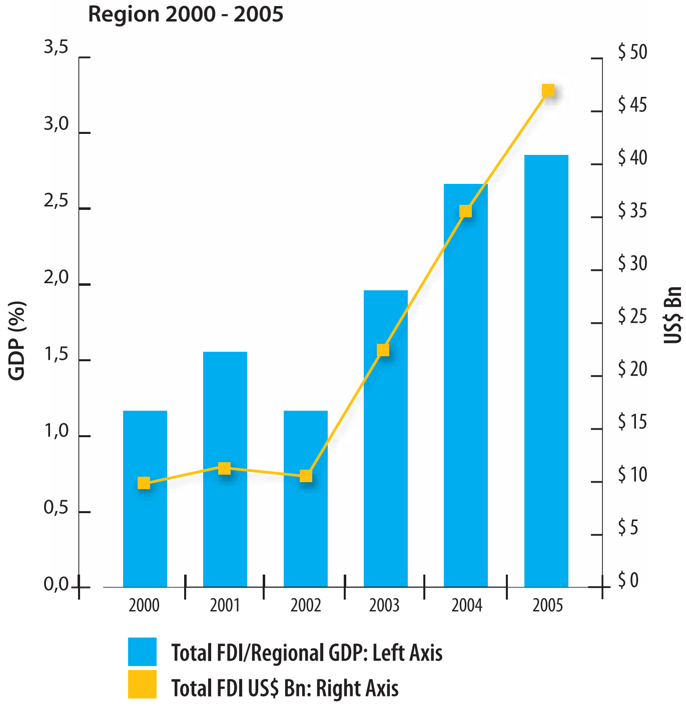
Figure 2: Trends in Regional Euromoney Country Risk Scores and Relative Differences[5]



5 Note: These are simplified representations based on arithmetic averages, prepared for illustrative purposes, and unweighted by relative size of economy. Nevertheless, they present the evolution of country risk scores over time. For the bars, an increase in score means an improvement (e.g. lowering) of country risk in that year, with 100 representing the maximum (e.g. lowest risk) score. For the lines, a declining trend indicates decreasing differences in country risk scores between the regions being compared (e.g. convergence of scores and country risk levels).

factors, particularly in the short term, including weak regulation, high probability of earning of rents, tax, legal or market distortions, etc. Nevertheless, readiness to 'put one's money where one's mouth is' or otherwise put effort and financial resources into an economy remains a useful indicator of how the economy is perceived by the actors themselves, particularly compared over time. By this measure, the Black Sea Region emerges favorably in recent years. Credit to private firms and households has grown rapidly in most regional countries, at sustained annual rates of growth exceeding 20% (and much higher for credit to households in certain countries). Interest rate margins- which incorporate calculations of risk- have declined substantially, and the length of average terms of lending have increased. While bank lending as a share of GDP still falls well short of the levels observed in countries with well developed long functioning financial systems (e.g. North America and EU-15), this is increasingly being viewed as a measure of the potential of the economy in question to develop its financial sector further, rather than merely an indication of how far behind it lags. Stock market performance in various regional economies was outstanding in 2005, and a further indication of investor willingness to enter and participate.

Figure 3: Foreign Direct Investment in the Black Sea Region 2000 - 2005



As for outsiders, the extent of their confidence in an economy can best be measured by the extent of foreign direct investment (FDI) attracted. Investors generally pursue the highest prospective returns available, and if the risk of failure or loss is high- for whatever reasons- then investment is either reduced, deferred, or simply not undertaken. Indeed, studies have established a link between levels of perceived country risk and foreign direct investment, with an inverse relationship existing between the two- the higher the country risk levels, the lower the FDI and conversely, the lower the country risk levels, the higher the levels of FDI normally recorded.

Figure 3 shows the positive trend in foreign direct investment in the Black Sea Region between 2000- 2005, with the level of FDI as a share of GDP more than doubling in 2005 relative to 2000- and even higher relative to historic averages from the 1990s. The Black Sea Region historically has lagged behind the eight new EU members from CEE & Baltics in attracting FDI, and while there is still room for further convergence, Azerbaijan, Armenia, Bulgaria, Georgia, Moldova, Romania, and Ukraine attracted at levels of FDI equivalent to at least 4% of GDP, levels that compare very favorably to those achieved by the CEE & Baltics countries and the most successful emerging economies globally. Azerbaijan exceptionally attracted FDI nearly 20% of GDP and Bulgaria near 10% of GDP, while Russia, Turkey, and Ukraine, attracted record high levels of FDI during 2005.

Given the high growth rate of the Region during this period, the fact that the level of foreign direct investment has doubled is even more impressive, for in absolute terms FDI into the Region has increased from US$ 8.0 billion in 2000 to an estimated US$ 46.8 billion for 2005, a nearly six-fold increase. This reflects successful privatization programs, illustrating the commitment of governments to reform, as well as purchases of private firms and green field investments, indicative of increased investor appetite for regional assets.

No one specific measure of country risk levels is absolute in and of itself, and either good results of bad may easily be taken out of context. However, a broad set of gauges and indicators approaching the issue of country risk for differing angles, and employing differing methodologies, can help in the formation of a composite picture. For the Black Sea Region, the set of gauges and indicators shows a confluence of trends and scores in the direction of an improving business environment and decreasing levels of country risk.

03

BSTDB in the Black Sea Region

BSTDB: realizing regional potential

2005 was another successful year in achieving the Bank's goal of mobilizing funds from both within and outside the Black Sea Region through products tailored to the business needs of regionally active enterprises and consistent with the Bank's mandate to accelerate development and promote cooperation among its shareholders. The business environment and in particular the investment climate improved in practically every Member State. These positive changes were facilitated by a number of factors, including steady economic outlook, EU accession process for Bulgaria, Romania and Turkey, benefits from higher energy prices for Russia and Azerbaijan, generally growing importance of energy sector for the whole BSTDB area and strengthening of local financial markets. In this environment, the Bank sought actively to support the positive trends.

In order to further adapt to those changes, the Bank initiated revisions of its operational documents. Furthermore, the Bank also created a new business group for financial institutions to develop and introduce new products to meet evolving regional business needs.

03 BSTDB in the Black Sea Region

Operations

In 2005 the Bank expanded activity across the Black Sea Region: 16 operations were approved by the Board of Directors for a total amount of SDR 129.3 million (USD 184.4 million). Of these operations, 4 were in manufacturing, 3 in energy & infrastructure and 9 through financial intermediaries.

17 operations were signed for a total amount of SDR 110.6 (USD 158.2) million. By sector, 10 operations were signed with financial institutions, 4 in manufacturing, and 3 in energy and infrastructure. By product, 14 were project finance, corporate loans and SME credit lines and 3 were trade finance operations.

Portfolio Description

The Bank continued to build up a diversified portfolio comprised mainly of short-term revolving trade finance facilities and medium to long term project and corporate finance loans. This strategy provides a sufficient degree of flexibility, allows an adequate response to market conditions and generates a balanced exposure to different classes of assets. The Bank maintains its portfolio quality by following an thorough due diligence process and by adhering to meticulous monitoring procedures.

Portfolio Structure by Country

By the end of 2005, the Bank's active portfolio consisted of 61[6] approved operations for a total of SDR 470 million (USD 672 million), distributed as follows:

6 The total number of approved active operations is 59, but one operation (SEAF – SME equity investment fund) is split among the three beneficiary countries, Albania, Bulgaria and Romania, resulting thus in a total number of operations by country of 61.

Selected BSTDB Financings

Glass Factory Project, Azerbaijan

BSTDB has provided a loan of EUR 5 million to International Bank of Azerbaijan (IBA) for on-lending purposes to Caspian Management Systems Ltd. (CMS), for building a glassware manufacturing company in Baku, Azerbaijan. The plant will manufacture glass bottles and jars for Azeri clients (such as manufacturers of preserved food and beverages) who currently import these glass containers, due to almost absent domestic supply. Key raw materials for the plant will be sourced from Azerbaijan and from Russia and Ukraine.

The plant will be erected under a turnkey contract, and will be equipped with modern technology imported from Italy. The investment will be realized in the Baku industrial area. It will utilize the infrastructure (water supply, gas, electricity etc.), as well as some assets (land, storage facilities, railway truck line etc.) of a former rubber plant that was closed down by the state and whose assets have been bought by CMS, under the privatization program, for the purpose of being utilized for the project.

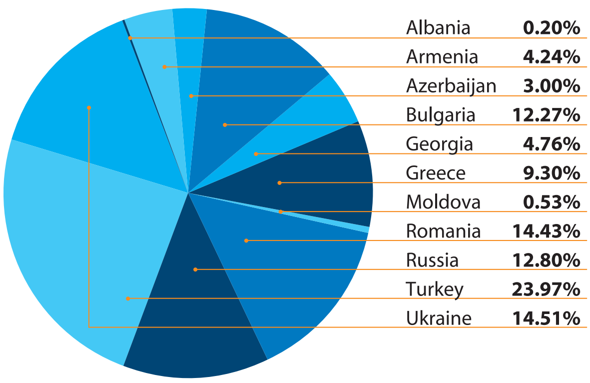
International Bank of Azerbaijan (IBA) is the most prestigious commercial bank in Azerbaijan, over 50% owned by the Azeri Ministry of Finance. Established in 1991, IBA has a dominant position in the Azeri banking sector, controlling the majority (over 60%) of the system's assets.

The project is expected to lead to substituting imports, while developing the non-oil manufacturing sector in the country. It is expected that when the project is completed, the plant will employ over 100 Azeri staff.

The project supports IBA's efforts to develop the Azeri private sector. In addition to the BSTDB funding to IBA for the project, CMS' shareholders provide EUR 5 million as equity, and IBA lends from its own sources EUR 5 million.

Terms & conditions of the operation:

Amount: EUR 5 million
Type of financing: Project Finance
Maturity: 5 years



Geographical diversification of the portfolio, in particular by expanding operations in small shareholder countries, was one of the objectives of BSTDB in 2005. As reflected in the figures above, the percentage of the operations in these countries increased from 6.72% in 2004 to 12.73% in 2005. The Bank approved 8 operations in small shareholder countries amounting to SDR 33.6 million (USD 47.5 million).

Co-financing

Among the Bank's transactions, 4 operations were co-financed with other financial institutions in 2005. The total project cost of these operations is SDR 1,188 million (USD 1,670 million), of which BSTDB's financing represents 3.9%. Since 1999, among the co-financiers with whom BSTDB cooperates are international financial institutions - EBRD, IFC and MIGA, official development institutions of developed countries - JBIC (Japan), DEG (Germany), SECO (Switzerland), Norfund and Finnfund in Scandinavia, and commercial banks – Calyon Bank, BNP Paribas S.A., ING Bank N.V., Cyprus Popular Bank, Citibank, US Ex-Im Bank, HVB Bank Romania SA, Bank Austria Creditanstalt AG, HVB Bank Romania S.A., Bayerische Hypo-Und Vereinsbank AG.

Selected BSTDB Financings Selected BSTDB Financings

Maritza East I Project, Bulgaria

BSTDB will participate in the financing of a 600 MW net lignite-fired power plant to be constructed in Bulgaria by Alstom and operated by a special purpose company AES-3C Maritza East I EOOD, an ultimate subsidiary of AES, one of the world's largest power producers. The amount of the BSTDB financing is Euro 18 million provided for a period of 16.5 years. The new power plant will be built to full EU standards for a total cost of approximately EUR 1.1 billion.

The proposed Project represents a major step for private sector participation in the Bulgarian economy as it represents one of the country's largest foreign direct investments to date. This is the largest new power generation investment in the country and will contribute to the advancement of the current restructuring of the sector.

The sector restructuring is a condition of Bulgaria's EU accession. The new plant will replace older, less efficient generation and lower the economic cost, thus benefiting consumers. The proposed project is a high priority for Bulgaria, utilizing the country's limited domestic fuel source. The project is structured to strengthen the development of a liberalized electricity market.

Maritza East Complex (ME 1,2 and 3) accounts for about 30% of the base load of the energy consumption in the country. The Bank is involved in ME 3 Project having committed EUR 20 million for 15 years. ME 1 Project is a natural extension and support by the Bank of the energy sector in Bulgaria. The project will also bring the following benefits to the country and the power sector:

- 10, 000 jobs within the framework of the whole project
- orders to local companies for over BGN 200 million as a result of the implementation
- BGN 40 million from tax revenues
- BGN 80 million annual revenues to Mini Maritza Iztok for coal delivery
- the Project is the largest green field investment in Central and Eastern Europe.

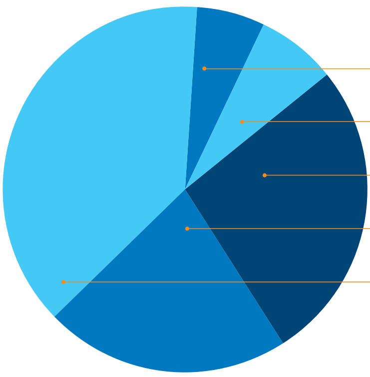
The readers of Project Finance magazine have selected the Maritza East I project as the European Power Deal of the Year 2005.

03 BSTDB in the Black Sea Region

Portfolio Structure by Sector

By sector, the Bank had at end 2005, 28 approved operations in financial institutions, 17 in manufacturing, 14 in energy and infrastructure (8 in energy, oil & gas, 3 in transport and public utilities, and 3 in telecommunications).

The structure of the portfolio in 2005 remained similar to the previous year. The most notable increases are in the telecommunication and transportation and public utilities sectors due to growth in demand. Their share of the portfolio has increased from 3.93 and 2.87% in 2004 to 7.03 and 5.99% in 2005 respectively. BSTDB's exposure to these two sectors is still lower than in others, due to the larger size and complexity of projects in these sectors. In 2005 the Bank has approved 1 operation in transport and public utilities and 1 operation in the telecommunication sector for the total amount of SDR 29.7 million.



By the end of 2005 the Bank had 54 operations signed and outstanding, of which 26 (SDR 73.9 million) were in the financial institutions sector, 15 (SDR 108.6 million) in manufacturing, 8 (SDR 57.9 million) in energy, oil & gas, 3 (SDR 16.3 million) in transport and public utilities sector, and 2 (SDR 18.2 million) in telecommunications.

Energy sector development has been a core activity for the Bank because of the priority status of this industry for BSTDB Member Countries, while in the manufacturing industry BSTDB put emphasis on the value added of its financing, taking advantage of its ability to provide attractive and competitive long-term facilities to clients in the region.

Selected BSTDB Financings

Terapia Project, Romania

BSTDB extended a USD 7 million medium-term corporate loan to Terapia S.A. (Romania) and to Terapia Holding B.V. (Netherlands), the Holding Company of Terapia S.A..

The funding from BSTDB was provided under a syndicated facility for financing the investment program of Terapia S.A., encompassing the extension of production facilities, modernization, maintenance and environmental protection of the plant in Romania, as well as acquisition of two small pharmaceuticals manufacturers.

Terapia is the second largest Romanian manufacturer of pharmaceuticals and produces prescription and non-prescription generic pharmaceuticals. In terms of market share, Terapia currently ranks sixth in the Romanian market, after international global players like GlaxoSmithkline, Novartis and Pfizer. Terapia Holding B.V. was founded in 2003 as an investment vehicle and holding company of Terapia S.A. Terapia has a long-established customer base, has built very good relations with its suppliers, and enjoys solid relationships with local and international commercial banks.

The BSTDB financing will contribute to the development of Terapia S.A., a strong private operator in the Romanian pharmaceutical industry and will support Terapia's efforts to complete its modernization and environmental clean-up program. It will also support Terapia S.A.'s endeavor to strengthen its competitiveness and expand its market presence.

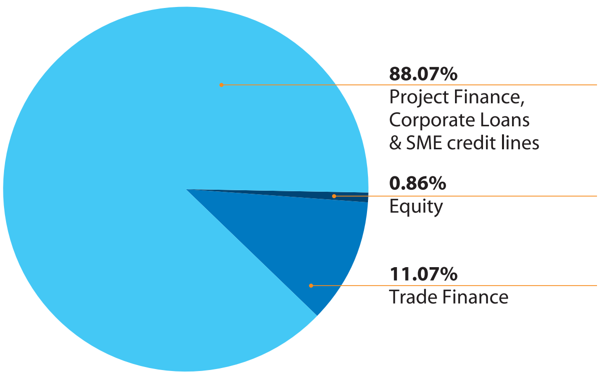
The operation is expected to lead to increased exports of Terapia S.A. products to BSEC Member Countries, given that Russia and Ukraine are the main export markets of Terapia S.A.

Terms & conditions of the operation:

Amount: USD 7 million, of which:
USD 3.5 million to Terapia S.A.
USD 3.5 million to Terapia Holding B.V.
Type of financing: Corporate Finance
Maturity: Terapia S.A.: 6 years
Terapia Holding: 5 years

Portfolio Structure by Product

Of the 59 active operations approved by the Bank's Board of Directors, 44 were project finance, corporate loans and SME credit lines, 13 were trade finance operations, and 2 equity operations.



The table above and the selected BSTDB financings reflect the pro-active stance of the Bank in supporting local financial institutions in promoting new financial products in order to meet the market demand. The Bank has approved 9 new operations with financial intermediaries in 2005. Total disbursements for operations signed with financial intermediaries in 2005 amounts to USD 100 million.

Trade Financing

Consistent with its dual mandate to promote development and regional cooperation, the Bank gives priority to the financing of commercial activities for goods and services produced and traded within the Member Countries, while promoting exports from Member Countries destined for countries inside as well as outside the Member Countries.

In 2005, BSTDB expanded its network of financial intermediaries by signing 10 operations for the purpose of delivering Trade Finance products in its Member States. SDR 51.1 million has been disbursed under Trade Financing operations in 2005.

The Bank's trade finance program seeks to contribute to the following objectives;

- Increasing intra-regional trade by assisting Member Country exporting and importing companies,
- Improving the competitive position of exporting companies in the Member Countries vis a vis external companies,

Selected BSTDB Financings

Ankara Esenboga Airport, Turkey

BSTDB extended a €18 million loan to TAV Esenboga Yatirim Yapim Ve Isletme A.S., a joint stock company, which won a public tender to design, construct and operate a new international and domestic passenger terminal at Ankara Esenboga Airport to replace the three existing passenger terminals.

Ankara Esenboga Airport is located 28 km, northeast of the city with good road links. The primary traffic using Ankara is Turkish citizens traveling within Turkey or internationally. The Project will integrate three terminal buildings into a new passenger terminal with a combined international and domestic capacity of approximately 10 million passengers per annum to standards similar to those in Western Europe. Together with the 160,000 m^2 terminal building there will be a multi-storey car park and a 30-stand apron, of which 18 stands have contact gates.

This Project is expected to bring about high developmental impact with socio-economic benefits to the region and the locality due to additional employment, both during construction and operation of the airport. Domestic industries supplying construction related materials and services are also expected to benefit during the construction period.

Implementation of the project should provide positive fiscal contribution to Turkey's GDP growth through generation of tax revenues, as well as ensuring solid mobilization of non-member countries capital since it will be funded by commercial banks and a development financial institution located outside of the Black Sea Region.

The total Project costs are estimated at around €196 million, of which a commercial loan will amount to up to €92 million. The BSTDB facility is an integral part of the commercial loan.

The readers of Project Finance magazine have selected the Ankara Airport transaction as the European Transportation Deal of the Year 2005.

Terms & conditions of the operation:

Amount: up to € 18,000,000
Type of financing: Limited Recourse Project Finance
Maturity: up to 12 years

03 BSTDB in the Black Sea Region

- Supporting the diversification of Member Country exports and generation of foreign exchange,
- Mitigating exporters' and importers' risks in transactions,
- and Strengthening financial institutions in the Region.

Recovery

The Bank successfully completed an 85% recovery on the one problem project carried over from previous years, while managing to keep the firm in question operating, and avoiding closure or laying off of staff. The loan in question was transferred to an established bank from the Black Sea Region, which has plans to develop the business further.

Special Fund

The Bank administers one Special Fund (the Hellenic Fund) established with the Contribution Agreement between the Government of the Hellenic Republic and BSTDB in July 2001. The Fund was instituted with an initial amount of Euro 800 thousand and was replenished by Euro 500 thousand in 2003. The Fund is tied to consulting companies and consultants based in Greece. However, up to 25% of an assignment cost may be allocated to consultants who are nationals of the Bank's other member countries.

Altogether, the Hellenic Fund has approved approximately Euro 605 thousand in consulting assignments since its creation. Out of this amount Euro 511 thousand have been disbursed. The sectors benefiting from these funds comprise telecom, oil & gas, manufacturing, transportation, banking, and agribusiness. These funds were distributed among eight member countries - Albania, Armenia, Bulgaria, Georgia, Greece, Moldova, Russia, and Ukraine. In 2005 the Fund supported two new assignments in Armenia and Moldova in the total amount of Euro 61 thousand. Both assignments contribute to operations in the agribusiness sector.

Environment Protection

The Bank has a distinctive environmental mandate for the region: protection of the Black Sea against pollution, promoting environmental soundness and encouraging sustainable development in all its loan operations. Thus, the Bank seeks to ensure that all the potential environmental risks arising from its operations are properly identified, assessed and mitigated. In line with this the Bank undertakes independent environmental assessment of all proposed operations. It analyses all the environmental implications, proposes efficient mitigation measures, and incorporates

 Selected BSTDB Financings Selected BSTDB Financings

Continuing Financing the Micro and Small Businesses in the Black Sea Region - Working with ProCredit Bank Georgia

In 2005 BSTDB extended Micro and SME loan facilities for USD 5 million and USD 6 million to ProCredit Bank Georgia (former Microfinance Bank of Georgia).

The credit lines are to finance sub-loans offered by Procredit Bank Georgia to micro, small and medium-sized enterprises in Georgia. The support that BSTDB is giving through Procredit Bank Georgia will benefit many eligible Georgian enterprises and deliver much-needed medium-term financing to the Georgian market.

Pro Credit Bank Georgia is a development oriented full service bank offering a wide range of banking products and services. The bank focuses on lending to micro, small and medium-sized enterprises in order to improve access to financing for the dynamic and fast-growing SME sector in the country.

Terms & conditions of the operation:

Total Amount: USD 11,000,000
Type of financing: Micro and SME Finance Facility

them into the overall decision-making process before the Bank makes a commitment to finance. For on-going operations the Bank closely monitors the environmental aspects of its financing.

In undertaking its environmental mandate the Bank is guided by its Environmental Policy and Environmental Assessment Procedures document. Assessment of the environmental acceptability of proposed transactions together with the environmental performance of the potential Clients is carried out in line with these procedures, as well as relevant best practices applied by other IFIs. All operations that pass the Banks Concept Clearance stage are subject to Environmental Assessment.

In the case of environmentally complex operations, which require an Environmental Impact Assessment for instance, or an Environmental Audit, the Bank commissions relevant studies. These studies focus on both the environmental acceptability of the project and the environmental performance of the potential borrower. Public consultations are also considered if the operation is a source of contention locally.

If identified issues of concern can be solved, an Environmental Action Plan is drawn up to ensure the client takes all the necessary measures to meet the Bank's environmental requirements during the life of the project. Financing is made dependent on progress towards these goals, so the client has a big incentive to comply.

The bank is closely working with other IFIs to ensure that clients are presented with consistency when trying to comply with lenders' environmental requirements, which is an important factor, as BSTDB is frequently co-financing with other agencies and banks.

The Bank is also closely cooperating with its counterparts elsewhere, as moves are made to harmonize environmental rules applied by the IFIs to project and trade finance.

Selected BSTDB Financings

Selected BSTDB Financings

Shelman Project, Greece

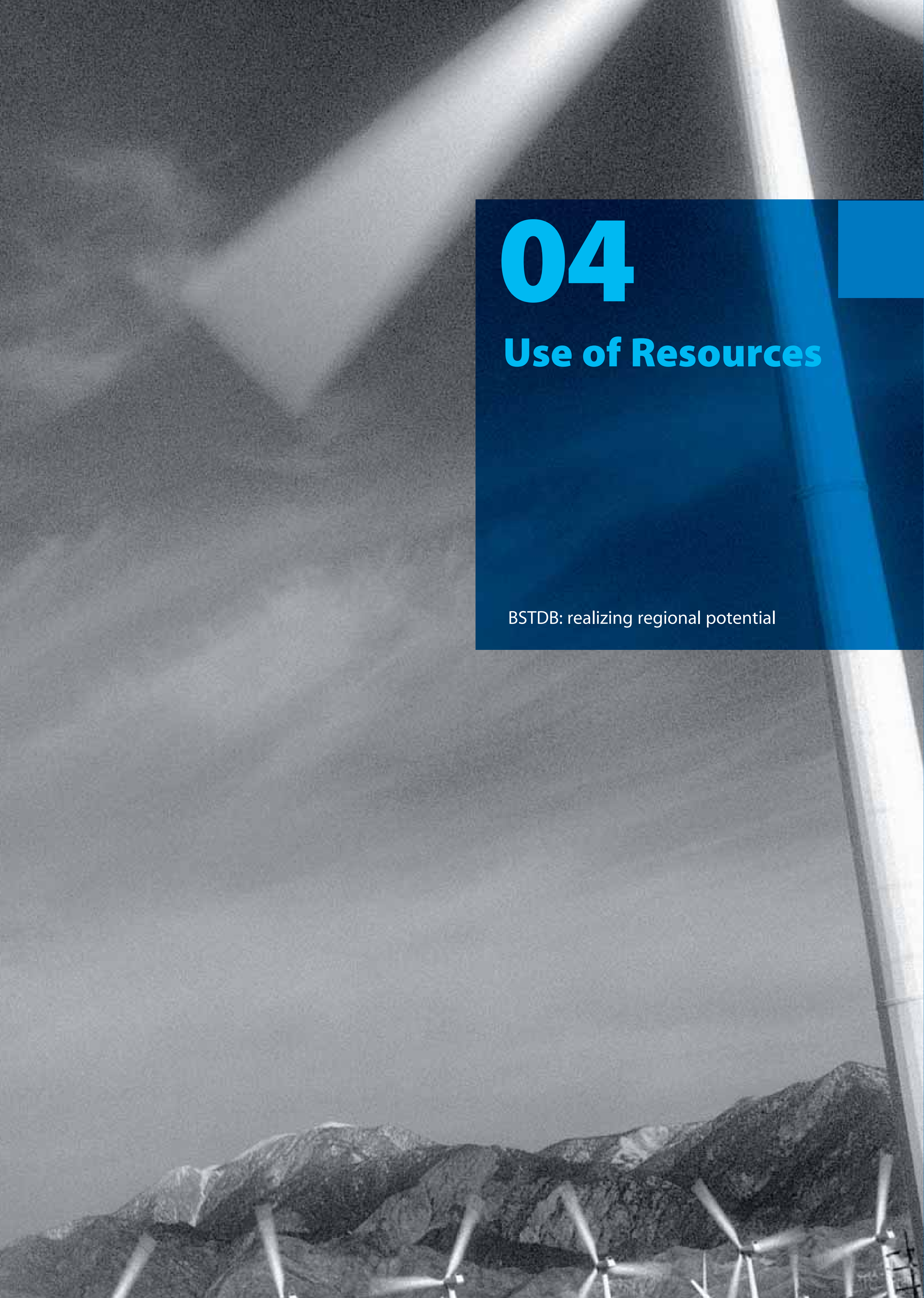
BSTDB extended a one-year maturity corporate loan of € 15 million, to Shelman Swiss Hellenic Wood Products Manufacturers S.A. (Shelman), the Greek market leader in the production of wood products for the financing of its corporate development program until 2009, focusing mainly in Greece.

BSTDB financing will allow Shelman to modernize its production facilities and also to perform research and development activities, as well as supporting the further expansion of its customer base in the Black Sea Region.

The development impact of the operation is thus strong, while the expansion of a regional 'blue chip' into neighboring markets will favorably impact regional cooperation, as the benefits extend to the Bank's Member Countries.

Terms & conditions of the operation:

Amount: € 15,000,000
Type of financing: Corporate Loan
Maturity: 1 Year



04

Use of Resources

BSTDB: realizing regional potential

RESOURCES MANAGEMENT

Human Resources

BSTDB recognises that human resources are a key factor in the ultimate success of the institution and strives to maintain its status as a competitive employer by following the best international standards and practices.

The Bank's recruitment policies provide for the hiring of employees on a wide geographical basis, preference being given to the citizens of member countries. At the end of 2005, the Bank had 94 employees, from 15 member and non-member countries.

During 2005 a number of key human resources policies were revised to increase the clarity, fairness and transparency of the system.

The Bank operates a market - oriented staff compensation and benefits policy designed to match the employment standards of other IFIs and in 2005, implemented a new health insurance scheme that emphasizes preventive health care and reduces administration requirements through an on-line claims and payments system.

The BSTDB Pension Plan, implemented in January 2003, is comprised of a fully funded defined benefit scheme and a matched contribution plan. This combination offers the flexibility crucial to best meet the needs of a multinational work force.

04 Use of Resources

Information Technologies

BSTDB has implemented a Disaster Recovery Site (DRS) in order to support the critical business processes and applications of the organization. The DRS is fully functional and operational. In the meantime, a Business Continuity Plan is under development and is expected to become operational within 2006.

As part of the IT SAP strategy, BSTDB has expanded its investment in SAP, by acquiring the SAP Treasury module for Banking and has proceeded with its implementation.

BSTDB has created a number of IT policies, guidelines and procedures in order to increase the security of its information and data, regarding their availability, integrity and confidentiality. These IT policies, guidelines and procedures, are in compliance with industry standards such as: COBIT and ISO 17799.

Administrative Services

New regulations regarding the review of awarded contracts were implemented, establishing practical guidelines for the periodical revision of vendor lists and the monitoring of cost cutting efforts in administrative expenses.

Updated record procedures were adopted at the end of the year, covering all issues relating to standardization of information formats, indexing, codification, circulation, maintenance and storage. Also, a comprehensive set of principles was adopted regarding the creation of a code of BSTDB rules and its internal dissemination, through the optimal use of the Intranet platform.

Accurate and timely business information was provided in a tailor-made way, thus assisting in the effective evaluation and monitoring of individual projects in all the phases of the operations' cycle.

External Relations And Communications

BSTDB continues to develop and strengthen its institutional relations with the Member State governments, the Organization of the Black Sea Economic Cooperation (BSEC) and its related bodies, as well as with other relevant international institutions while striving to promote regional cooperation.

In 2005 BSTDB made a focused effort to support regional business events, including the business forum on "Private Sector Development in the Black Sea region" co-organized by the Greek Government, the OECD Development Center and the Business Council of BSEC. The Bank also sponsored business generation conferences in Moldova and Russia. In its drive to develop business contacts and to promote investments in the region, the Bank hosted its annual Black Sea Business Day in Yerevan in June 2005 under the auspices of the Armenian Government and with the support of local business associations and foreign investors.

Relations with international institutions and IFIs active in the region received a new impetus with the signing of two updated Memoranda of Understanding with the European Commission and major IFIs on coordination and co-operation in economic development and EU accession preparation of some BSTDB member countries (Albania, Bulgaria, Romania, and Turkey), as well as on cooperation for other BSTDB Member States participating in the CIS.

The Bank continued promoting its relationships with non-regional governments and institutions with a view to developing joint activities in the region. Some Western European governments and their financial institutions considered joining BSTDB as Observer, with KfW of Germany applying for the status in December 2005.

In 2005 the Bank approved a new Public Information Policy which made an important move to increased openness and public accountability.

Planning And Budgeting

The Bank's planning process, carried out within the directives of the Board of Directors approved policies and guidelines, aims to prioritize the Bank's operational objectives within the scope of its mission statement. The process incorporates the formulation of operational priorities, country and sector strategies, preparation of annual budget and resource allocations. It may also include the preparation of operational policy papers supporting the implementation of specific strategy initiatives.

The Bank is committed to budgetary discipline to ensure effective utilization of resources. Execution of the Annual Budget is monitored on an ongoing basis and the results reported to the Board of Directors on a quarterly basis.

The Bank also has established Management Information Systems to support its internal structure by providing detailed financial and management information. This is utilised for decision-making, performance reporting, monitoring and internal control purposes. Such financial information and reports are prepared and distributed at the appropriate levels of responsibilities.

FINANCIAL MANAGEMENT

Revenues

In this year of operation, the Bank increased the size of its lending outstanding portfolios to SDR 277,656 thousand. Total income from lending activities rose to SDR 19,854 thousand during the year from SDR 12,429 thousand in 2004. Treasury activities in 2005 generated total interest income of SDR 1,702 thousand from placements with other financial institutions and investment in short-term money market instruments. The total operating income for the year was SDR 19,564 thousand.

Expenses

Administrative expenses, including depreciation, for the year were SDR 9,179 thousand, a decrease of SDR 646 thousand on 2004. Administrative expenses include salaries, benefits and other administrative costs.

Salaries and benefits, in the amount of SDR 7,137 thousand showed a modest increase of SDR 189 thousand from the previous year. This included a supplementary amount of SDR 444 thousand recognised in the actuarial valuation of the Bank's staff retirement plan. Other administrative costs have shown a decrease from the previous year due to the expected reimbursement of rental expenses by the Host Country.

Overall, administrative expenses were well within the 2005 Budget, reflecting the Bank's effective cost controls.

Capital Base

As specified in the Establishing Agreement, the BSTDB's initial authorised capital stock is one billion (1,000,000,000) Special Drawing Rights (SDR) divided into one million (1,000,000) shares, each with a par value of one thousand (1,000) SDR.

All participating Member States of the Bank had fully subscribed to their portion of the initial authorized capital stock. The subscribed capital is composed of:

- ten per cent (10%) fully paid shares
- twenty per cent (20%) paid by promissory notes (eightequal annual instalments, encashment starting from the year 1998) and
- seventy per cent (70%) callable shares.

The aggregate par value of the initial authorised fully paid shares is SDR 100 million and that of the capital paid by promissory notes is SDR 200 million. At the Sixth Annual Meeting of the Board of Governors held in June 2004, Armenia, Georgia and Moldova requested a fifty per cent reduction of their portion of subscribed capital, which was approved by the Board of Governors.

As of 31 December 2005, SDR 291 million were due to be paid-up by the participating Member States, in accordance with the schedule stipulated in the Agreement. This included the ten per cent fully paid shares and the eighth and final annual instalment of the twenty per cent shares payable by promissory notes. The total initial authorized capital stock of the Bank of SDR one billion remained unchanged.

Gearing Ratio

The Establishing Agreement places a number of institutional limitations on the use of the Bank's capital for its ordinary operations. Treasury investments, comprising the Bank's investment of its capital and those assets held for liquidity purposes, are considered auxiliary to the Bank's ordinary operations.

The Bank's institutional gearing ratio, the statutory limit on the total amount of ordinary operations (outstanding loans, equity investments and guarantees) is 150% of the Bank's unimpaired subscribed capital, reserves and surpluses, and as at 31 December 2005 stood at slightly above SDR 1.5 billion.

At the 36th meeting of the Board of Directors, the operational gearing ratio was set at 100% of the Bank's unimpaired paid-up capital, reserves and surpluses and the usable portion of callable capital. This limit on the total amount of operations is approximately SDR one billion.

Provisioning

The IFRS compliant provisioning policy is designed to ensure that the level of general provisions is commensurate with overall portfolio risk levels. While each operation contributes to the general provisions, specific provisions are only allocated if and when a specific operation encounters difficulties. Total provisions at end of 2005 stood at SDR 20,548 thousand equivalent to 7.4% of the outstanding loans and equity investments.

The institutional target to be achieved for a level of general provisions and reserves, over time, is set at 10% of the total outstanding exposures, less the gross value of non-performing operations.

Market Risks

Market risk management is conducted within a framework of conservative risk limits and policy documents approved by the Board of Directors. More specific subsidiary documents detailing credit risk parameters, liquidity restrictions, interest rate and foreign exchange risk are approved on an ongoing basis by the appropriate executive committees.

04 Use of Resources

It is the policy of the Bank to take no significant interest rate or foreign exchange exposure. Asset and liability maturities and interest rate tenors are matched wherever possible and the SDR denominated capital, reserves and surpluses are invested in the SDR constituent currencies at weightings intended to keep foreign exchange exposure to a minimum.

Investment / Liquidity

The Bank's surplus funds totalled SDR 87,809 thousand as at 31 December 2005, and were invested in two types of money market instruments:

- short-term deposits with institutions long term rated at a minimum of A2/A either Moody's or Standard & Poor's credit rating agency.
- Euro commercial paper rated at a minimum short term A2/P2 by either Moody's or Standard & Poor's credit rating agency.

Investments are denominated in one of the four SDR component currencies and performance is monitored monthly against the Merrill Lynch 3 month Libid index.

The Banks liquidity ratio calculated as liquid assets over 12 months net cash requirements including signed undisbursed commitments, stood at 220% on 31 December 2005.

Borrowing

In 2005 BSTDB launched its second syndicated borrowing, a USD 50 Million Term Loan Facility signed on January 12, 2006. Bayerische Landesbank (Germany), Natexis Banques Populaires (France) and SANPAOLO IMI Bank Ireland plc (Ireland) acted as lead arrangers for the Facility, while General Bank of Greece, Landesbank Rheinland-Pfalz (Germany), Erste Bank (Austria), Kommunalkredit International Bank Ltd. (Austria), HSH Nordbank AG (Germany) and ExImBank of the Republic of China also joined the Facility.

During 2005 Moody's Investor Services reaffirmed the Bank's investment grade ratings of long term Baa2 and short term P2. As the size of the operations portfolio continues to increase, and taking into consideration its minimum liquidity requirements, the Bank will access sources of long term funds.

Risk Analysis

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

Risk Mitigation

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

Evaluation

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

Preferred Creditor Status

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

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

CORPORATE GOVERNANCE

Management Structure

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

The BSTDB's governing constitution is set out in the Agreement Establishing the Bank. This document requires that the institution be managed by a Board of Governors, a Board of Directors, a President, Vice Presidents, a Secretary General and such officers and staff as may be necessary. Each of the Member State of the Bank is represented on the Board of Governors. All powers of the Bank are vested in the Board of Governors. With certain exceptions the Board of Governors has delegated the exercise of these powers to the Board of Directors, while still retaining overall authority.

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

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

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

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

Compliance

The Bank's Compliance and Operational Risk Management Office has the responsibility for implementing anti-money-laundering measures by overseeing integrity issues and maintaining sound institutional practices. Financial due diligence is integrated into the Bank's normal approval of new business and to the review of existing activity. The Bank screens all uncertain transactions to ensure that they do not represent a money laundering risk.

The Bank provides corporate integrity and anti-money-laundering training to its staff in order to raise skill levels and increase awareness of these concerns.

Reporting And Disclosure

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

With respect to external financial reporting, the Bank presents financial statements in its quarterly Summary Statements and in the Annual Report. Pursuant to Article 35 of the Establishing Agreement, these reports are transmitted to the Governments of the Member States (Annual Report only), members of the Board of Governors and Directors and the BSEC Permanent International Secretariat. The Annual Report for 2005 is the seventh report published following the commencement of operations of the Bank.

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

Internal Audit

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

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

External Auditors

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

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

05 Financial Statements and Notes

BSTDB: realizing regional potential

Financial Statements and Notes

Financial Statements for the Year Ended
31 December 2005
Together with Auditor's Report

INCOME STATEMENT

For the year ended 31 December 2005

Expressed in thousands of SDR	Note	2005	2004
Interest and similar income			
From loans		17,931	10,845
From placements with financial institutions		469	454
From investments held-to-maturity		1,233	1,579
Interest expense and similar charges	15	(2,009)	(495)
Net interest income		**17,624**	**12,383**
Net fees and commissions	4	1,923	1,584
Net income (loss) on foreign exchange		39	(82)
Other income (expense)		(22)	(3)
Operating income		**19,564**	**13,882**
Administrative expenses	5	8,887	9,406
Depreciation	13,14	292	419
Income before impairment		**10,385**	**4,057**
Impairment losses on loans	6	7,027	4,256
Net income (loss) for the year		**3,358**	**(199)**

The accompanying notes are an integral part of this statement.

BALANCE SHEET

At 31 December 2005

Expressed in thousands of SDR	Note	2005	2004
Assets			
Cash and bank balances	18	21,695	2,690
Placements with financial institutions	18	16,763	24,546
Investments held-to-maturity	18	49,351	18,671
Total deposits and investments		87,809	45,907
Financial assets available-for-sale	9,11	3,920	2,557
Derivative financial instruments	8	495	863
Loans	10,11	273,736	244,310
Less: impairment losses on loans	6	(20,548)	(13,310)
Loans net of impairment		253,188	231,000
Other assets	12	6,790	6,051
Property and equipment	13	239	289
Intangible assets	14	388	354
Total Assets		**352,829**	**287,021**
Liabilities			
Borrowings	15	42,858	6,654
Payables and accrued interest	16	713	353
Deferred income	4	2,150	2,387
Total liabilities		45,721	9,394
Members' Equity			
Authorised share capital	7	1,000,000	1,000,000
Less: unallocated share capital	7	(30,000)	(30,000)
Subscribed share capital	7	970,000	970,000
Less: callable share capital	7	(679,000)	(679,000)
Less: payable share capital	7	0	(24,250)
Advance against future call	7	35	29
Paid-in share capital		291,035	266,779
Reserves	17	5,682	3,666
Retained earnings		10,391	7,182
Total members' equity		307,108	277,627
Total Liabilities and Members' Equity		**352,829**	**287,021**
Off-balance-sheet items			
Commitments	11	57,776	79,617

The accompanying notes are an integral part of this statement.

STATEMENT OF CHANGES IN MEMBERS' EQUITY

For the year ended 31 December 2005

	Share capital				Retained	
Expressed in thousands of SDR	Subscribed	Callable	Payable	Reserves	earnings	Total
At 31 December 2003	**1,000,000**	**(700,000)**	**(49,943)**	**3,666**	**7,381**	**261,104**
Net (loss) for the year					(199)	(199)
Unallocated share capital	(30,000)	21,000	750			(8,250)
Paid-in share capital			25,000			25,000
Advance against future call			(28)			(28)
At 31 December 2004	**970,000**	**(679,000)**	**(24,221)**	**3,666**	**7,182**	**277,627**
Net gain of available-for-sale (note 9)				1,867		1,867
Income recognised directly in equity				1,867		1,867
Net income for the year					3,358	3,358
Total income for the year				1,867	3,358	5,225
Paid-in share capital			24,250			24,250
Advance against future call			6			6
General reserve				149	(149)	0
At 31 December 2005	**970,000**	**(679,000)**	**35**	**5,682**	**10,391**	**307,108**

The accompanying notes are an integral part of this statement.

STATEMENT OF CASH FLOWS

For the year ended 31 December 2005

Expressed in thousands of SDR	Note	2005	2004
Cash flows from operating activities			
Net income (loss) for the year		3,358	(199)
Adjustment for:			
Impairment losses on loans	6	7,027	4,256
Depreciation	13,14	292	419
Interest and similar income		(19,633)	(12,878)
Interest expense and similar charges		2,009	495
Foreign exchange adjustments on provisions	6	211	(321)
Operating income before changes in operating assets		(6,736)	(8,228)
Decrease (increase) in other assets	12	(166)	1,109
Increase (decrease) in accounts payable	16	346	(325)
Increase (decrease) in deferred income	4	(237)	210
Interest and similar income received		18,266	12,608
Interest and similar ch arges paid	16	(1,995)	(476)
Cash generated from operations		9,478	4,898
Proceeds from repayment of loans	10	141,072	93,136
Proceeds from repayment of available-for-sale		1,273	577
Funds advanced for loans	10	(170,496)	(167,073)
Funds advanced for available-for-sale		(770)	(509)
Net cash used in operating activities		(19,443)	(68,971)
Cash flows from investing activities			
Purchase of property, technology and equipment	13	(276)	(125)
Net cash used in investing activities		(276)	(125)
Cash flows from financing activities			
Increase in paid-in share capital	7	24,250	16,750
Decrease (increase) in share capital S.T. receivable	7	1,162	7,024
Increase (decrease) in advance against future call	7	6	(28)
Paid-in share capital received		25,418	23,746
Increase in borrowings	15	53,463	36,961
Repayments of borrowings	15	(17,260)	(30,307)
Net cash provided by financing activities		61,621	30,400
Net increase (decrease) in cash and cash equivalents		**41,902**	**(38,696)**
Cash and cash equivalents at beginning of year		45,907	84,603
Cash and cash equivalents at end of year	**18**	**87,809**	**45,907**

The accompanying notes are an integral part of this statement.

Financial Statements and Notes

Notes to the Financial Statements
For the year ended 31 December 2005

1. ESTABLISHMENT OF THE BANK

1.1 **Agreement Establishing The Bank**

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

The purpose of the Bank is to accelerate development and promote cooperation among its shareholder countries. As a regional development institution it is well placed to mobilise financial resources and to improve access to financing for companies in the whole region as well as for those active only in its individual Member Countries. The Bank offers project and trade financing facilities and including equity participations and guarantees that can be tailored made to meet individual requirements.

As at 31 December 2005 the Bank's shareholders comprised 11 countries: Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russian Federation, Turkey and Ukraine.

1.2 **Headquarters Agreement**

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

1.3 **Approval Of Financial Statements**

The financial statements for 2005 have been submitted by the Management Committee to the Board of Directors for approval on 14 April 2006. Pursuant to Article 23 of the Agreement, these financial statements shall be subject to approval by the Board of Governors in their Annual Meeting to be held on 11 June 2006.

2. SIGNIFICANT ACCOUNTING POLICIES

2.1 **Basis Of Financial Statements**

The accompanying financial statements are a complete set of financial statements and have been prepared in accordance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board. The financial statements have been prepared on a historical cost basis except for the measurement of available for sale financial assets and financial assets at fair value through income statement that have been measured at fair value. The Bank has not applied any IFRS before their effective dates.

The Bank's unit of account is Special Drawing Rights (SDR) for its authorised share capital, in accordance with Article 4 of the Agreement. Pursuant to this, the Bank's functional currency is the SDR component currencies and that all transactions are recorded in these original currencies. The Bank's presentation currency is the SDR.

2.2 **Foreign Currencies**

Foreign currency transactions are initially recorded in SDR by applying to the foreign currency amount the exchange rate between the SDR and the foreign currency at the rate prevailing on the last day of the month, preceding the date of the transaction, as provided by the IMF. Exchange gains and losses arising from the translation of monetary assets and liabilities at year-end exchange rates are taken to the income statement.

Exchange rates used by the Bank at the balance sheet date have as follows:

		31 December 2005	31 December 2004
1 SDR =	United States dollar	1.42927	1.55301
	Euro	1.20756	1.13874
	Japanese yen	168.04000	159.10600
	Pound sterling	0.83005	0.80409

2.3 **Financial Instruments**

Financial instruments are composed into financial assets, financial liabilities and derivatives.

2.3.1 **Financial Assets – Investments**

The Bank classifies investments into the following categories; financial assets at fair value through income statement, available-for-sale financial assets and held-to-maturity financial assets. Their classification is determined at the time of acquisition and accounted for at trade date.

2.3.1a **Financial assets at fair value through income statement**

Are those that are acquired with the intention to earn profit from short-term price fluctuations such as commercial paper or are a part of portfolio with a short term profit target. These financial assets are initially recorded at cost. Any related acquisition cost is not capitalized but is taken directly to the income statement. After their initial recognition they are measured at fair value.

The realized gains and losses from the sale or repurchase of these financial assets as well as their fair value adjustments are recorded in the income statement. The related interest and dividend income earned is also recorded in the income statement.

2.3.1b **Available-for-sale**

Financial assets such as the Bank's equity investments are classified as available-for-sale. After initial recognition at cost these financial assets are measured at fair value. The fair value of the available for sale securities that are traded in organized financial markets is determined by reference to quoted market bid prices, security traders or discounted cash flow models. For those where there is no active market fair value is determined using accepted valuation techniques.

The unrealized gains and losses which arise from fluctuations in fair value are recognized as a separate component of equity until the financial asset is sold or derecognized for any other reason or until the investment is determined to be impaired, at which time, the cumulative gain or loss previously reported in equity is included in the income statement.

An investment in securities is considered to be impaired when its accounting value exceeds its recoverable amount and events and circumstances indicate that the carrying amount may not be recoverable in the future.

2.3.1c **Held-to-maturity**

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

The interest arising from investment securities is reported as interest income in the income statement.

2.3.1d **Derivative financial instruments**

The Bank enters into transactions in derivative instruments primarily in foreign exchange forward contracts. Derivative financial instruments are initially recognized in the balance sheet at cost and subsequently are remeasured at their fair value.

Fair values are obtained from quoted market prices, to the extent publicly available, discounted cash flows and options pricing models as appropriate. All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

For derivatives that do not qualify for special hedge accounting, any gains or losses arising from changes in fair value are taken directly to net income or loss for the period.

2.3.1e **Loans and advances to customers**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction. Subsequently, loans are measured at amortised cost using the effective interest rate method. All loans are recognized when cash is advanced to borrowers at settlement date.

Loans and advances are classified as non-performing when payment of interest or principal is contractually past due and unpaid. Interest accrued on these loans is not recognised as income until cash is received.

2.3.1f **Impairment for loan losses**

Based upon its evaluation of credits granted, the Bank estimates the total credit risk provision that it believes is adequate to cover uncollectible amounts in the Bank's loan and receivable portfolio including losses under guarantees and commitments. If there is objective evidence that the Bank will not be able to collect all amounts due (principal and interest) according to original contractual terms of the loan, such loans are considered and classified as "non-performing". The amount of the loss is measured as the difference between the loan's carrying amount and the present value of expected future cash flows discounted at the loan's original (or current) effective interest rate as determined under the contract, or as the difference between the carrying value of the loan and the fair value of collateral, if the loan is collateralized and foreclosure is probable.

Impairment and uncollectibility are measured and recognized individually for loans and receivables that are individually significant, and on a portfolio basis for a group of similar loans and receivables that are not individually identified as impaired.

The Bank ceases to accrue interest on those loans classified as non-performing for more than 90 days, or earlier when there is reasonable doubt as to actual collection, and for which the recoverable amount is determined primarily in reference to fair value of collateral.

On the portfolio basis, management estimates that SDR 14,391 thousand allowance over cash and non-cash loans (excluding those that are non-performing) respectively, is adequate to cover potential or unforeseen uncollectible amounts in the existing performing cash and non-cash loan portfolio.

The carrying amount of such assets is reduced to its estimated recoverable amount through use of an allowance for impairment account. A write-off is made when all or part of a loan is deemed uncollectible or in the case of debt forgiveness. Write-offs are charged against previously established allowances and reduce the principal amount of a loan. Recoveries of loans written off in earlier periods are included in the income statement.

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

2.3.2 Recognition And Derecognition

The Bank recognizes a financial asset or financial liability in its balance sheet when and only when it becomes a party to the contractual provisions of the instrument. The evaluation of the transfer of risks and rewards of ownership precedes the evaluation of the transfer of control for all derecognition transactions. The Bank derecognizes a financial asset or a portion of financial asset when and only when it loses control of the contractual rights that comprise the financial asset or a portion of the financial asset. The Bank derecognizes a financial liability when and only when a liability is extinguished, that is when the obligation specified in the contract is discharged, cancelled and expired.

2.4 Property And Equipment

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

• Furniture, furnishings and appliances	20.0%
• Personal computers	33.3%
• Office and telecommunication equipment	20.0%
• Transportation vehicles	20.0%

Expenditure on leasehold buildings and improvements are depreciated over the remaining term of the lease.

2.5 **Intangible Assets**

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

2.6 **Impairment Of The Value of Assets**

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

2.7 **Staff Retirement And Termination Benefits**

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

- The first pillar is a defined benefit scheme financed entirely by the Bank. The Bank's contributions are determined on the basis of actuarial valuations using the projected unit credit method, performed annually by qualified, independent actuaries;
- The second pillar is a defined contribution scheme to which both the employee and the Bank contribute equally at a rate of 0-7.5% of basic salary. Each employee determines his/her contribution rate and the mode of investment of the contributions; and
- The third pillar is a defined contribution scheme funded entirely by each employee, up to 40% of basic salary.

Local staff is alternatively entitled to retirement benefits from the Greek State Social Insurance Fund (IKA), which is a defined contribution scheme.

Current service costs in respect of both the pension plan and social insurance contribution schemes (IKA) are recognised as an expense and included in "Administrative expenses".

Employee termination indemnities are charged to the income statement when there is a formal plan to terminate the employment of eligible employees.

2.8 **Taxation**

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

2.9 **Borrowings**

Borrowings are stated at cost. Borrowing costs are recognised as expenses and recorded on an accrual basis.

2.10 **Other Provisions**

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

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

2.12 **Netting of Assets And Liabilities**
The netting off of assets and liabilities in the financial statements is permitted only if a contractual right exists which allows the netting off of such balances as well as the intention for the mutual settlement of the whole amount of the asset or the liability, or of the settlement of the amount which arises following the netting off of the balances.

2.13 **Income And Expenses**
Interest income and expense are recorded on an accrual basis, with the exception on those assets that are individually identified as impaired for which interest is recognised through unwinding the discount used in the present value calculations applied to the expected future cash flows. In accordance with IAS 18, front-end fees and where applicable commitment fees, pertaining to loans are amortised through the income statement using the effective interest rate method over the life of the loans. In the case of early repayment, cancellation or acceleration the outstanding deferred income from the related fees are recalculated taking into account the new maturity date.

Other commitment and guarantee fees and fees received in respect of services provided over a period of time are recognised as income on an accrual basis matching the period during which the commitment exists or the services are provided. Dividends are recognised when received. Administrative expenses are recorded on an accrual basis.

2.14 **Government Grants**
Government grants are recognised were there is reasonable assurance that the grant will be received and all attaching conditions will be complied with.

2.15 **Cash And Cash Equivalents**
For the purpose of the "statement of cash flows" cash and cash equivalents consist of cash on hand, placements with other financial institutions and debt securities with maturities of three months or less.

2.16 **Use Of Estimates**
The preparation of financial statements involves management estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Differences in judgement may arise from impairment losses on loans as referred in note 6 and the staff retirement plan as referred in note 22. Such differences are believed not material and do not affect these financial statements.

2.17 **Judgements**
In the process of applying the Bank's accounting policies, management has made certain judgements apart from those involving estimations, which have been described in the notes that follow.

3. RISK MANAGEMENT

3.1 Financial Risk

The Bank is exposed to financial risk through its financial assets and liabilities including the receivables from these financial assets. The key aspects of financial risk are (i) credit risk (ii) liquidity risk (iii) foreign exchange risk (iv) interest rate risk and (v) market risk.

The basic principle of the Bank as far as the management of the financial risk is concerned, is the equivalent matching of assets and liabilities from the lending and the investment contracts.

3.1.1 Credit Risk

The Bank is subject to credit risk, which is the risk that a counter party will be unable to meet its obligations as they fall due. Customers are the main source of credit risk since they might be unable to cover their part of the obligation or of the claims that have already been attributed to the Bank. The Bank reviews on a regular basis the credit limits of counterparties and takes actions accordingly.

3.1.2 Liquidity Risk

The liquidity risk concerns the ability of the Bank to fulfil its financial obligations as they become due. The management of the liquidity risk is concentrated on the timing of the cash in-flows and out-flows as well as in the adequacy of the available cash and high liquidity securities. For this, the Bank estimates and relates all expected cash flows from assets and liabilities.

3.1.3 Foreign Exchange Risk

The Bank operates in the Black Sea Region and is subject to exchange rate risk coming mainly from the translation of the SDR constituent currencies.

3.1.4 Interest Rate Risk

The interest rate risk is the risk that arises from changes in the future financial cash flows due to fluctuations of interest rates.

The Bank closely monitors the consequences of interest rate risk analysing the duration of its lending and investment securities portfolios, along with its relevant liabilities, in combination with the money market developments.

3.1.5 Market Risk

Market risk refers to the probability of losses due to changes or fluctuations in the market prices of securities, interest rates and exchange rates that directly influence the fair valuations of securities. The Bank uses modern methods for the measurement of market risk like the "Value-at-Risk". It assesses potential losses on a portfolio over a given future time period with a given degree of confidence. It does not however assess losses arising from exceptionally unusual changes.

3.2 **New Accounting Standards And Interpretations Of IASB**

The International Accounting Standards Board along with the Interpretation Committee has already issued new accounting standards and interpretations that will be effective from the 2006 financial year. The Bank believes that the consequences of these new standards will be as follows:

IFRS 6: Exploration for and evaluation of mineral resources.
Does not apply to the Bank and will not affect the financial statements.

IFRS 7: Financial Instruments: Disclosures.
This will be applied by the Bank but will not affect the financial statements.

IFRIC Interpretation 3: Emission rights.
Does not apply to the Bank and will not affect the financial statements.

IFRIC Interpretation 4: Determining whether an arrangement contains a lease.
Does not apply to the Bank and will not affect the financial statements.

IFRIC Interpretation 5: Rights to interests arising from decommissioning, restoration and environmental rehabilitation.
Does not apply to the bank and will not affect the financial statements.

4. NET FEES AND COMMISSIONS

Net fees and commissions are analysed as follows:

Expressed in SDR (000)	Year to 31 December 2005	Year to 31 December 2004
Front-end fees	986	686
Commitment fees	280	251
Guarantee fees	113	163
Management fees	100	97
Appraisal fees	68	111
Prepayment/cancellation fees	317	244
Other	59	32
Net fees and commissions	**1,923**	**1,584**

The deferred income balance as of 31 December 2005 was SDR 2,150 thousand and as of 31 December 2004 was SDR 2,387 thousand. Such amounts are recognised in the income statement over the period from disbursement to repayment of the related loan in accordance with IAS 18.

5. ADMINISTRATIVE EXPENSES

Administrative expenses in the income statement are analysed as follows:

Expressed in SDR (000)	Year to 31 December 2005	Year to 31 December 2004
Salaries and benefits	5,823	6,058
Staff retirement plan (note 22)	1,314	890
Other administrative expenses	2,331	2,458
Total	9,468	9,406
Host country reimbursement	(581)	0
Administrative expenses	**8,887**	**9,406**

The average number of staff employed during the year was 96 (2004: 97). The number of staff at 31 December 2005 was 94 (2004: 97)

6. IMPAIRMENT LOSSES ON LOANS

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

Expressed in SDR (000)	Portfolio	Specific	Total
At 1 January	11,574	1,736	13,310
Charges/(releases) for the year:			
Charges	5,224	5,618	10,842
Releases	(3,247)	-	(3,247)
Against amounts written off	-	(568)	(568)
For the year ended 31 December	1,977	5,050	7,027
Foreign exchange adjustments	311	(100)	211
Other adjustments	529	(529)	0
At 31 December 2005	**14,391**	**6,157**	**20,548**

At 31 December 2005 the Bank categorised one loan as impaired. The total exposure amounts to SDR 7,689 thousand and the provision on this asset amounted to SDR 6,157 thousand.

7. SHARE CAPITAL

In accordance with Article 4 of the Agreement, the initial authorised share capital of the Bank is one billion SDR divided into one million shares having a par value of one thousand SDR each. All participating members had fully subscribed to their portion of the initial authorised share capital in accordance with Article 5 of the Agreement.

Subsequently, at the Sixth Annual Meeting of the Board of Governors held on 6 June 2004, three Member States, Armenia, Georgia and Moldova requested a fifty per cent reduction of their portion of subscribed capital, from 2% to 1% of total authorised capital. The Board of Governors approved their request, recognising the importance of full commitment of the Member States by way of payment of obligations towards their respective shares. The total initial authorised capital stock of the Bank of SDR one billion remained unchanged. The issued share capital at end of the year is analysed as follows:

Expressed in SDR (000)	At 31 December 2005	At 31 December 2004
Authorised share capital	1,000,000	1,000,000
Less: unallocated share capital*	(30,000)	(30,000)
Subscribed share capital	970,000	970,000
Less: shares not yet called	(679,000)	(679,000)
Less: shares called but not yet due	0	(24,250)
Called-up share capital	291,000	266,750
Advance against future call	35	29
Paid-in share capital	**291,035**	**266,779**

* Shares available to new or existing Member States.

In accordance with paragraph 2 under Article 6 of the Agreement, all Member States were required to pay their share of the first issue of shares of SDR 100 million within 60 days after the date on which they became members of the Bank. In accordance with paragraph 3 under the same Article, a second issue of shares of SDR 200 million was made in 1998 and payment for these shares shall be made by each Member State by promissory notes or other obligation issued by such member in eight equal successive annual instalments in the years 1998 to 2005.

At end 2005 four Member States had not yet fully settled the called up and due portion of their capital obligations. The balance of share capital due but not received at 31 December 2005 was SDR 2,740 thousand and at 31 December 2004 was SDR 3,902 thousand.

The capital subscription status and voting power, which is based on the paid amount, of each member has no any changes since 31 December 2004 and as 31 December 2005 is analysed as follows:

		Subscribed	Callable	Payable	Paid	
Member	Shares	Expressed in SDR (000)				Voting power
Albania	20,000	20,000	14,000	6,000	5,501	1.9%
Armenia	10,000	10,000	7,000	3,000	3,000	1.0%
Azerbaijan	20,000	20,000	14,000	6,000	5,277	1.8%
Bulgaria	135,000	135,000	94,500	40,500	40,500	14.0%
Georgia	10,000	10,000	7,000	3,000	2,000	0.8%
Greece	165,000	165,000	115,500	49,500	49,500	17.2%
Moldova	10,000	10,000	7,000	3,000	2,482	0.9%
Romania	135,000	135,000	94,500	40,500	40,500	14.0%
Russian Fed.	165,000	165,000	115,500	49,500	49,500	17.2%
Turkey	165,000	165,000	115,500	49,500	49,500	17.2%
Ukraine	135,000	135,000	94,500	40,500	40,500	14.0%
Total	**970,000**	**970,000**	**679,000**	**291,000**	**288,260**	**100%**

8. DERIVATIVE FINANCIAL INSTRUMENTS

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

The table below shows the fair values of such instruments together with the notional amounts analysed by the term to maturity. The notional amount is the amount of a derivative's underlying asset, reference rate or index and is the basis upon which changes in the value of derivatives are measured. The notional amounts indicate the volume of transactions outstanding at year-end and are neither indicative of the market risk nor credit risk.

The fair values of forward exchange contracts are calculated by using forward exchange rates at the balance sheet date. In the absence of reliable forward rate estimations in a volatile market, the current market (spot) rate is considered to be the best estimate of the present value of the forward exchange rates.

	At 31 December 2005		At 31 December 2004	
Expressed in SDR (000)	Notional amount	Fair value	Notional amount	Fair value
Forward purchase contracts	30,543	30,433	48,552	48,101
Forward sales contracts	30,737	30,928	48,996	48,964
Derivative financial instruments	**194**	**495**	**444**	**863**

9. FINANCIAL ASSETS AVAILABLE-FOR-SALE

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

			At 31 December 2005		At 31 December 2004	
Expressed in SDR (000)	% of investment	Total net equity	Carrying amount	Fair value	Carrying amount	Fair value
SEAF Trans-Balkan Fund LLC	18.33	10,080	1,848	2,696	1,031	1,430
Micro Finance Bank of Azerbaijan	25.55	4,417	1,129	1,224	986	1,127
Financial assets available-for-sale			**2,977**	**3,920**	**2,017**	**2,557**

The valuation of such investments has been based on their latest audited accounts as of the 31 December 2004. An increase of SDR 1,867 thousand was due to an unrealized gain in fair value, which was attributable to the Bank's participation. The Bank has not realized any gains or losses during the year.

10. LOANS

The Bank offers a range of financial instruments for both project and trade financing, tailored to meet an individual operation's requirements. The Bank may also make equity-financing investments and provide guarantees. Loans may be denominated in any convertible currency, or a combination of convertible currencies in which the Bank is able to fund itself.

Expressed in SDR (000)	At 31 December 2005	At 31 December 2004
At 1 January	244,310	170,373
Disbursements	144,445	155,330
Less: repayments	(125,341)	(77,340)
Foreign exchange movements	10,964	(4,053)
Written off	(642)	0
At end of year	273,736	244,310
Less: impairment losses on loans (note 6)	(20,548)	(13,310)
Loans net of impairment	**253,188**	**231,000**

As of 31 December 2005 there are no loans on which interest is not being accrued, or where interest is suspended.

Interest is generally based on 3 and 6 months Libor for USD loans and Euribor for EUR loans plus a margin. Margins are dependent on the risk category of each loan and typically range from 1.5% to 4.0%.

The fair value of the loan portfolio is approximately equal to book value because all loans bear a variable interest rate and are given at market conditions and terms. Further analysis of the loan portfolio is presented in note 11.

11. OPERATIONAL ANALYSIS

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

	At 31 December 2005		At 31 December 2004	
Expressed in SDR (000)	Outstanding disbursements	Undrawn commitments	Outstanding disbursements	Undrawn commitments
Analysis by instrument				
Loans	273,736	57,505	244,310	72,492
Equity investments*	3,920	271	2,557	907
Guarantees	-	-	-	6,218
At end of year	**277,656**	**57,776**	**246,867**	**79,617**
Analysis by country				
Armenia	769	1,014	391	0
Azerbaijan	8,776	5,335	3,240	2,072
Bulgaria	23,103	16,172	30,250	18,741
Georgia	12,238	5,947	5,696	3,035
Greece	42,050	0	52,840	6,701
Moldova	157	2,327	0	2,020
Romania	25,975	1,423	17,895	10,275
Russia	32,839	16,792	29,871	12,878
Turkey	71,157	7,096	69,807	1,288
Ukraine	57,896	1,399	35,447	21,700
Regional	2,696	271	1,430	907
At end of year	**277,656**	**57,776**	**246,867**	**79,617**
Analysis by sector				
Financial institutions	60,502	17,830	41,136	18,670
Manufacturing	128,505	20,805	142,480	18,654
Infrastructure	88,649	19,141	63,251	42,293
At end of year	**277,656**	**57,776**	**246,867**	**79,617**

* The Bank's equity investments are included in the available-for-sale financial assets (note 9).

12. OTHER ASSETS

Other assets in the accompanying balance sheet are analysed as follows:

Expressed in SDR (000)	At 31 December 2005	At 31 December 2004
Receivables and accrued interest	3,203	1,836
Paid-in share capital not received	2,740	3,902
Advances and prepaid expenses	212	259
Rental reimbursement receivable*	581	0
Guarantee deposits	54	54
Other assets	**6,790**	**6,051**

* The Hellenic Republic will grant the rental already being reimbursed amounting to SDR 581 thousand.

13. PROPERTY AND EQUIPMENT

Property and equipment in the accompanying balance sheet are analysed as follows:

Expressed in SDR (000)	Buildings (leasehold)	Vehicle	Furniture and office accessories	Computers and office equipment	Total
Cost					
At 31 December 2003	129	32	343	914	1,418
Additions	0	0	1	87	88
Disposals	0	0	0	(10)	(10)
At 31 December 2004	129	32	344	991	1,496
Additions	17	0	4	85	106
At 31 December 2005	**146**	**32**	**348**	**1,076**	**1,062**
Accumulated depreciation					
At 31 December 2003	104	22	263	615	1,004
Charges for the year	18	6	46	143	213
Disposals	0	0	0	(10)	(10)
At 31 December 2004	122	28	309	748	1,207
Charges for the year	9	4	22	121	156
At 31 December 2005	**131**	**32**	**331**	**869**	**1,363**
Net book value					
At 31 December 2005	**15**	**0**	**17**	**207**	**239**
At 31 December 2004	7	4	35	243	289

14. INTANGIBLE ASSETS

Intangible assets* in the accompanying balance sheet are analysed as follows:

Expressed in SDR (000)	Total
Cost	
At 31 December 2003	1,023
Additions	37
At 31 December 2004	1,060
Additions	170
At 31 December 2005	**1,230**
Accumulated amortisation	
At 31 December 2003	500
Charges for the year	206
At 31 December 2004	706
Charges for the year	136
At 31 December 2005	**842**
Net book value	
At 31 December 2005	**388**
At 31 December 2004	354

* Intangible assets comprises of computer software.

15. BORROWINGS

Borrowing facilities arranged at end of year were SDR 55,280 of which an amount of SDR 12,422 was not used, as analysed below. In addition to medium or long-term borrowings, the Bank utilises short-term financing in the form of borrowings from major commercial banks for cash management purposes.

	At 31 December 2005		At 31 December 2004	
Expressed in SDR (000)	Amount used	Borrowings arranged	Amount used	Borrowings arranged
Euro	0	12,422	0	13,172
Other	42,443	42,443	6,439	39,065
United States dollar	415	415	215	215
Total	**42,858**	**55,280**	**6,654**	**52,452**

The Interest rate on borrowings is approximately within a range of USD Libor+50 points and maturing in a three-year period. There is no collateral against the above borrowed funds. The fair value of the borrowings is approximately equal to carrying value.

16. PAYABLES AND ACCRUED INTEREST

Payables and accrued interest in the accompanying balance sheet are analysed as follows:

Expressed in SDR (000)	At 31 December 2005	At 31 December 2004
Interest payable	82	68
Social insurance fund (IKA) contributions	18	8
Pension plan obligation (note 22)	444	24
Suppliers and other accrued expenses	169	253
Payables and accrued interest	**713**	**353**

17. RESERVES

Reserves in the accompanying balance sheet are analysed as follows:

Expressed in SDR (000)	At 31 December 2005	At 31 December 2004
General reserve	3,815	3,666
Revaluation reserve	1,867	0
Reserve	**5,682**	**3,666**

The general reserve constitutes any unforeseeable risks or contingencies that may not qualify as provisions and is normally build-up from released provisioning charges during the year. In addition in 2005, a revaluation reserve has been created relating to the unrealized gain of equity investment.

18. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, placements with other financial institutions and financial assets with maturities of three months or less. In the accompanying balance sheet they are analysed as follows:

Expressed in SDR (000)	At 31 December 2005	At 31 December 2004
Cash	1	1
Bank balances/placements and/or investments:		
Up to 1 month	87,808	39,621
From 1 month to 3 months	0	6,285
Total deposits and investments	**87,809**	**45,907**

The commercial paper held in the Bank's portfolio is rated A2/P2 and above, in accordance with internal financial policies.

19. CURRENCY RISK

The Bank's policy is to have no significant foreign exchange position, but to invest its SDR denominated capital and reserves in the SDR constituent currencies in proportion to their weight in determining the value of SDR.

The table below provides a currency breakdown of the Bank's assets and liabilities.

Expressed in SDR (000)	United States dollar	Euro	Japanese yen	Pound sterling	Special drawing right	**Total**
Assets						
Cash and bank balances	696	201	20,491	307		**21,695**
Placements with financial institutions	14,693	2,070				**16,763**
Investments held-to-maturity		7,449	5,951	35,951		**49,351**
Financial assets available-for-sale	3,920					**3,920**
Derivative financial instruments					495	**495**
Loans	190,902	82,834				**273,736**
Impairment losses on loans	(18,394)	(2,154)				**(20,548)**
Other assets	1,842	1,446	232	318	2,952	**6,790**
Net property and equipment					239	**239**
Net intangible assets					388	**388**
Total assets	193,659	91,846	26,674	36,576	4,074	**352,829**
Liabilities						
Borrowings	42,858					**42,858**
Payables and accrued interest	50	663				**713**
Deferred income					2,150	**2,150**
Members' equity					307,108	**307,108**
Total liabilities and members' equity	42,908	663	0	0	309,258	**352,829**
Net assets (liabilities)	150,751	91,183	26,674	36,576	(305,184)	**0**
Derivative financial instruments	(30,433)	18,885	12,018	25	(495)	**0**
Net currency balance at 31 December 2005	**120,318**	**110,068**	**38,692**	**36,601**	**(305,679)**	**0**
Correct SDR weights*	123,404	107,837	38,201	36,237	305,679	
Currency position at 31 December 2005	(3,086)	2,231	491	364	0	
Net currency balance at 31 December 2004	**101,833**	**102,789**	**36,462**	**34,072**	**(275,156)**	**0**

* As per IMF rule (effective as of 1 January 2001).

20. LIQUIDITY RISK

Liquidity is a measure of the extent to which the Bank may be required to raise funds to meet its obligations. The Bank's commitment to maintaining a strong liquidity position is established in policies, approved by the Board of Directors, that require a minimum target liquidity ratio of 50% (liquid assets divided by the net cash requirements for the next twelve months). Liquid assets are maintained in short-term placements and negotiable securities.

The table below provides an analysis of assets, liabilities and members' equity by relevant maturity groupings based on the remaining period from the balance sheet date to the contractual maturity date. It is presented under the most prudent consideration of maturity dates where options or repayment patterns allow for early repayment possibilities. Therefore, in the case of liabilities the earliest possible repayment date is shown, while for assets it is the latest possible repayment date. Those assets and liabilities that do not have a contractual maturity date are grouped together in the "maturity undefined" category.

Expressed in SDR (000)	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Maturity undefined	**Total**
Assets							
Cash and bank balances	21,695						**21,695**
Placements with financial institutions	16,763						**16,763**
Investments held-to-maturity	49,351						**49,351**
Financial assets available-for-sale						3,920	**3,920**
Derivative financial instruments						495	**495**
Loans	10,010	25,695	72,163	145,530	20,338		**273,736**
Impairment losses on loans						(20,548)	**(20,548)**
Other assets	2,952	3,784				54	**6,790**
Net property and equipment						239	**239**
Net intangible assets						388	**388**
Total assets	100,771	29,479	72,163	145,530	20,338	(15,452)	**352,829**
Liabilities							
Borrowings				42,443		415	**42,858**
Payables and accrued interest		713					**713**
Deferred income	2,150						**2,150**
Members' equity						307,108	**307,108**
Total liabilities and members' equity	2,150	713	0	42,443	0	307,523	**352,829**
Liquidity position at 31 December 2005	**98,621**	**28,766**	**72,163**	**103,087**	**20,338**	**(322,975)**	**0**
Liquidity position at 31 December 2004	**41,697**	**29,038**	**49,018**	**151,982**	**15,354**	**(287,089)**	**0**

* The fair value of investment securities maturing up to one year approximates the book value.

21. INTEREST RATE RISK

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

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

	Bearing floating interest						
Expressed in SDR (000)	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Non-interest bearing	**Total**
Assets							
Cash and bank balances	21,694					1	**21,695**
Placements with financial institutions	16,763						**16,763**
Investments held-to-maturity	49,351						**49,351**
Financial assets available-for-sale						3,920	**3,920**
Derivative financial instruments						495	**495**
Loans	14,970	119,659	133,440	5,667			**273,736**
Impairment losses on loans						(20,548)	**(20,548)**
Other assets						6,790	**6,790**
Net property and equipment						239	**239**
Net intangible assets						388	**388**
Total assets	102,778	119,659	133,440	5,667	0	(8,715)	**352,829**
Liabilities							
Borrowings		42,443				415	**42,858**
Payables and accrued interest						713	**713**
Deferred income						2,150	**2,150**
Members' equity						307,108	**307,108**
Total liabilities and members' equity	0	42,443	0	0	0	310,386	**352,829**
Interest rate risk at 31 December 2005	**102,778**	**77,216**	**133,440**	**5,667**	**0**	**(319,101)**	**0**
Interest rate risk at 31 December 2004	**68,634**	**108,644**	**104,778**	**1,721**	**0**	**(283,777)**	**0**

22. STAFF RETIREMENT PLAN

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

An actuarial valuation of the defined benefit scheme is performed each year by a qualified actuary taking into consideration the Bank's human resources strategy and policies.

Expressed in SDR (000)	At 31 December 2005	At 31 December 2004
Amounts recognised in the balance sheet		
At 1 January	32	331
Current service costs	870	866
Employee contributions	405	399
Past service obligation	444	24
Contributions paid	(1,289)	(1,588)
At end of year	**462**	**32**
Amounts recognised in the income statement		
Current service costs:		
Defined benefits scheme	494	509
Defined contributions scheme	299	309
Greek social insurance fund	77	48
Past service obligation	444	24
Total included in administrative expenses	**1,314**	**890**
Principal actuarial assumptions used		
Discount rate	4.2%	5.4%
Expected return on plan assets	6.0%	6.0%
Future salary increases	2.3%	3.0%
Average remaining working life of employees	21 years	21 years

23. OPERATING LEASES

The Bank has entered into lease contracts for its Headquarters and other premises. These are operating leases and include renewal options and periodic escalation clauses. There is no commitment at end of period for non-cancellable lease contracts. Rental expenses for the period included in "Administrative expenses" totalled SDR 610 thousand (SDR 568 thousand in 2004).

24. SPECIAL FUNDS ADMINISTERED BY THE BANK

Special funds may be established in accordance with Article 16 of the Agreement and are administered under the terms of rules and regulations adopted by the Bank. At 31 December 2005 the Bank administered one such fund the Technical Cooperation Special Fund. The assets and fund balance are not included in the Bank's balance sheet.

The objective of the fund, which has been funded by the Hellenic Republic, is to contribute to the economic development of the Black Sea Region's Member Countries. The fund extends technical assistance grants for preparation of high quality project documentation including business plans, feasibility studies and financial reporting methods and standards. The movement in the fund for the years 2005 and 2004 is shown below.

Expressed in SDR (000)	At 31 December 2005	At 31 December 2004
Fund statement of movement		
Balance of fund brought forward	723	802
Contribution received	0	0
Interest and other income	11	16
Less: disbursements	(104)	(120)
Less: other operating expenses	(2)	(2)
Foreign exchange movements	(40)	27
Balance of fund available	**588**	**723**
Fund balance sheet		
Assets		
Placements with other financial institutions	588	723
Total Assets	**588**	**723**
Liabilities		
Allocated fund balance	0	0
Unallocated fund balance	588	723
Total Liabilities and contributor's resources	**588**	**723**

Auditor's Report

To the Board of Directors of the
Black Sea Trade and Development Bank

We have audited the accompanying balance sheet of the Black Sea Trade and Development Bank (hereinafter called the Bank) which comprise the balance sheet as at 31 December 2005, the related income statement, statement of changes in members' equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes. These financial statements are the responsibility of the Bank's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

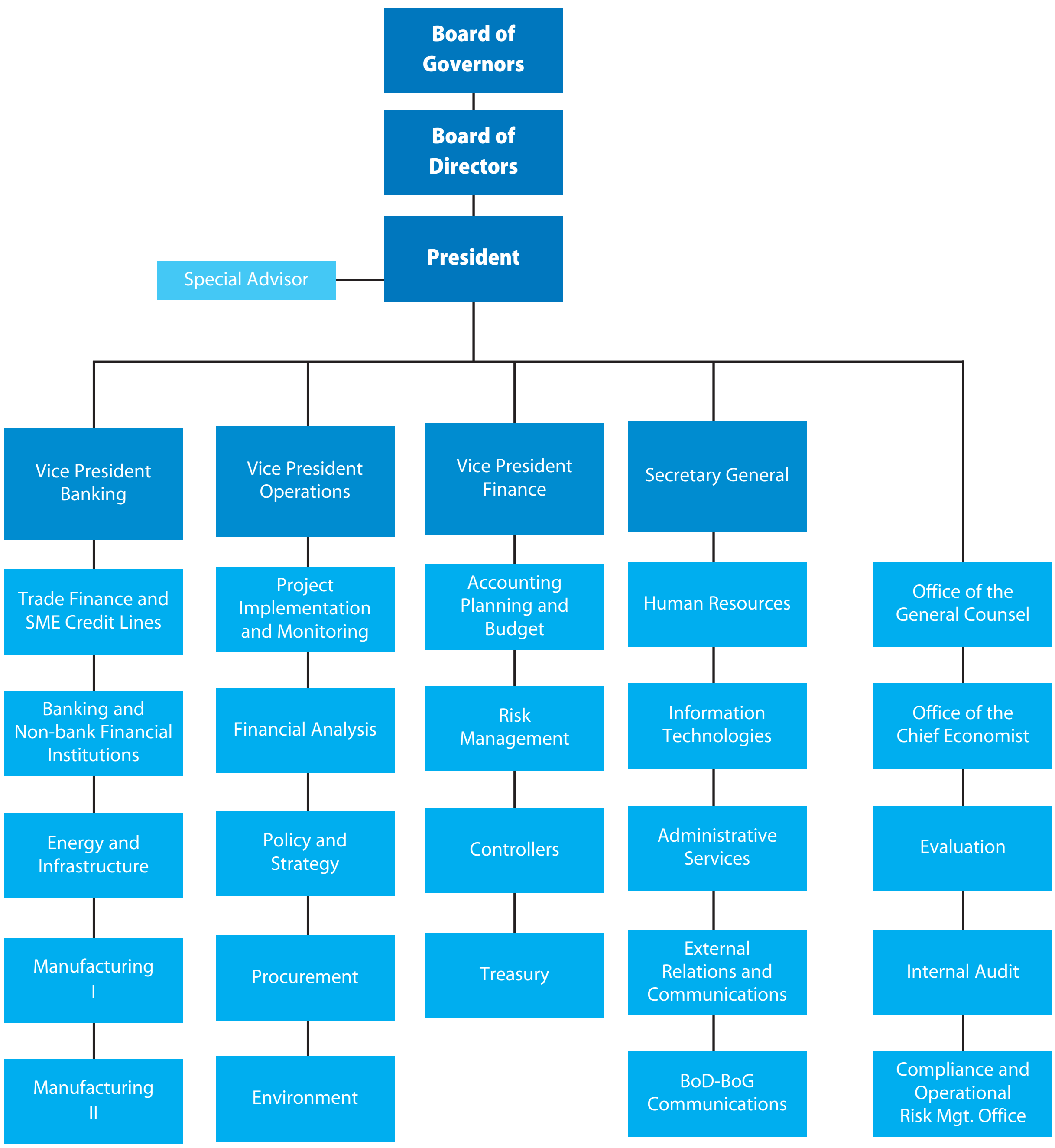
In our opinion, the financial statements give a true and fair view of the financial position of the Bank as of 31 December 2005 and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards.

Ernst and Young,

Athens, Greece,
15 March 2006

Annex I

Organisational Structure



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