



Black  
Sea  
Trade &  
Development  
Bank



Annual Report

07





# Annual Report

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### Black Sea Trade & Development Bank

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# Board of Governors

As of 31 December 2007

## Republic of Albania

Governor: Mr. Sherefedin Shehu, Deputy Minister of Finance  
 Alternate Governor: Mr. Eno Bozdo, Deputy Minister of Economy, Trade and Energy

## Republic of Armenia

Governor: Mr. Vardan Khachatryan, Minister of Finance and Economy  
 Alternate Governor: Mr. David Avetissian, Deputy Minister of Finance and Economy

## Republic of Azerbaijan

Governor: Mr. Heydar Babayev, Minister of Economic Development  
 Alternate Governor: Mr. Samir Sharifov, Minister of Finance

## Republic of Bulgaria

Governor: Mr. Dimiter Ivanovski, Deputy Minister of Finance  
 Alternate Governor: Mr. Atanas Kanchev, Deputy Minister of Finance

## Georgia

Alternate Governor: Mr. Kakha Baindurashvili, First Deputy Minister of Finance

## Hellenic Republic

Governor: Mr. Ioannis Sidiropoulos, General Secretary, Ministry of Economy and Finance  
 Alternate Governor: Mr. Konstantinos Kollias, General Director, Training Centre (SEYYO), Ministry of Economy and Finance

## Republic of Moldova

Governor: Mr. Mihail Pop, Minister of Finance

## Romania

Governor: Mr. Varujan Vosganian, Minister of Economy and Finance  
 Alternate Governor: Mr. Sebastian Vladescu, Secretary of State, Ministry of Economy and Finance

## Russian Federation

Governor: Ms. Svetlana Ganeeva, Director of Investment Policy Department, Ministry of Economic Development and Trade  
 Alternate Governor: Mr. Dmitri Pankin, Director, International Finance Department, Government Debt and Assets, Ministry of Finance

## Republic of Turkey

Governor: Mr. Ibrahim Canakci, Undersecretary of Treasury  
 Alternate Governor: Mr. Cavit Dagdas, Deputy Undersecretary of Treasury

## Ukraine

Alternate Governor: Mr. Anatoliy Shapovalov, First Deputy Governor, National Bank of Ukraine

# Board of Directors

As of 31 December 2007

## Republic of Albania

Director: Mr. Nezir Haldeda, General Treasury Director, Ministry of Finance  
 Alternate Director: Ms. Anila Cili, Director of Treasury Department, Ministry of Finance

## Republic of Armenia

Director: Mr. Arthur Javadyan, Vice Governor, Central Bank of Armenia  
 Alternate Director: Mr. Nerses Mkrtchian, Head of International Economic Cooperation Department, Ministry of Foreign Affairs

## Republic of Azerbaijan

Director: Mr. Mikayil Jabbarov, Deputy Minister of Economic Development

## Republic of Bulgaria

Director: Ms. Nina Stavreva, Head of Minister's Cabinet, Ministry of Finance  
 Alternate Director: Ms. Gergana Beremska, State Treasurer, Ministry of Finance

## Georgia

Director: Mr. Dimitri Gvindadze, Deputy Minister of Finance  
 Alternate Director: Mr. George Chikava, Deputy Head of Operations Department National Bank of Georgia

## Hellenic Republic

Director: Mr. Dimitrios Giannos, General Director for International Economic Policy, Ministry of Economy and Finance  
 Alternate Director: Ms. Zoe Driva Evangelopoulou, Director for International Organizations Directorate, International Financial Organizations, Ministry of Economy and Finance

## Republic of Moldova

Director: Ms. Elena Matveeva, Director of Public Debt Department, Ministry of Finance  
 Alternate Director: Ms. Ina Gorea, Head of External Cooperation Division, Ministry of Finance

## Romania

Director: Ms. Diana Peligrad Blindu, Programs Coordinator, General Directorate for External Public Finance, Ministry of Economy and Finance  
 Alternate Director: Mr. Stefan Petrescu, General Director, General Directorate for External Public Finance, Ministry of Economy and Finance

## Russian Federation

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

## Republic of Turkey

Director: Mr. Memduh Akcay, Director General of Foreign Economic Relations, Undersecretariat of Treasury  
 Alternate Director: Mr. Mustafa Boran, Deputy General Director of Foreign Economic Relations, Undersecretariat of Treasury

## Ukraine

Director: Mr. Valeriy Pyatnytskiy, Deputy Minister of Economy  
 Alternate Director: Mr. Andrey Kravets, Deputy Minister of Finance

## Audit Committee

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As of 31 December 2007

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Chairperson:

**Ms. Diana PELIGRAD BLINDU**, BSTDB Director for Romania

Members:

**Mr. Nezir HALDEDA**, BSTDB Director for the Republic of Albania

**Mr. Dimitri GVINDADZE**, BSTDB Director for Georgia

**Ms. Elena MATVEEVA**, BSTDB Director for the Republic of Moldova

## Management

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As of 31 December 2007

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**Hayrettin Kaplan**  
President,  
Chairman of the  
BSTDB Board of  
Directors



**Andrey Kondakov**  
Vice President  
Banking



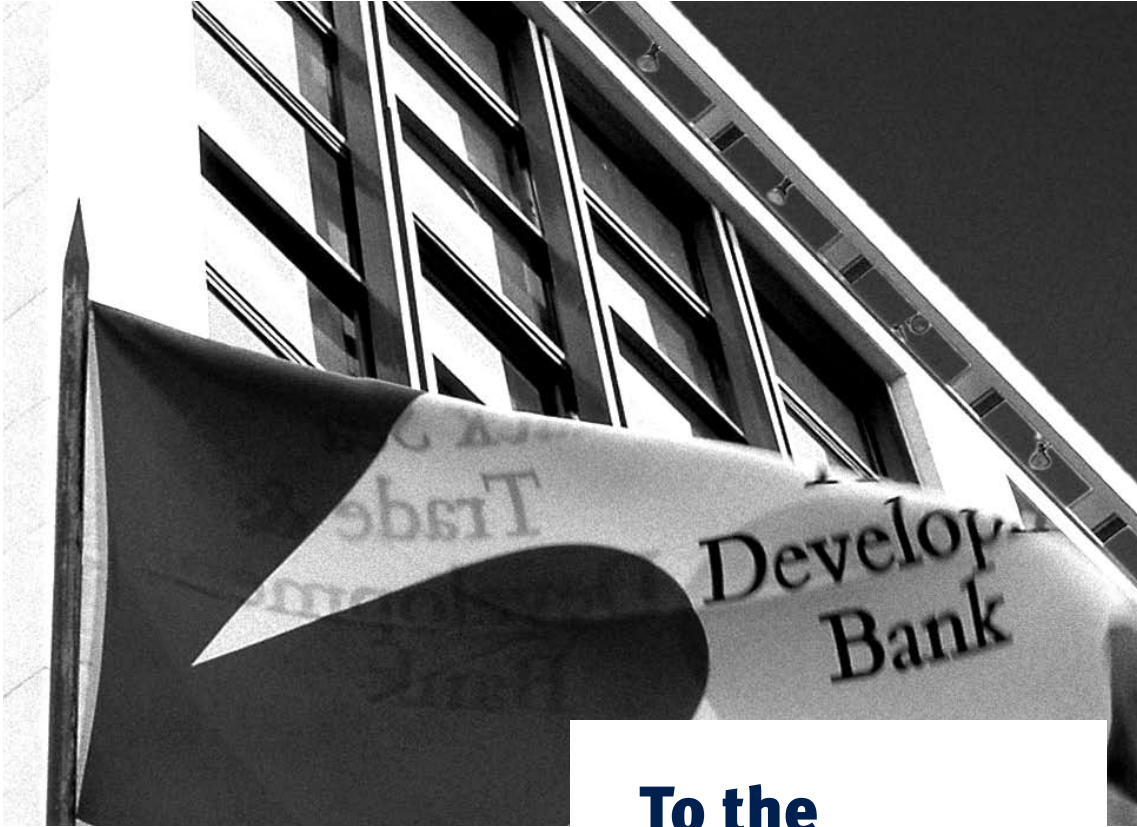
**Vitalii Mygashko**  
Vice President  
Operations



**Sophia Kassidova**  
Vice President  
Finance



**George Kottas**  
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 2007 as endorsed by the Board of Directors. The Ninth 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**  
President,  
Chairman of the  
BSTDB Board of Directors

# Statement by the President

In many respects, 2007 was a landmark year for the Black Sea Trade and Development Bank. It represented the first full year of the Bank's Medium Term Strategy and Business Plan for the period 2007-2010 which emphasizes clear strategic directions as the institution matures and moves beyond establishing its name and niche. These include (i) managed growth with a greater emphasis on cross-country operations, broadening of sectors, and focusing on smaller countries and needier regions of Member States, (ii) adaptability to the changing needs of existing clients and attraction of promising new clients or those who may require assistance to update their corporate governance, and (iii) offering new, longer term, or more complicated financial products which the growing sophistication of Black Sea markets requires.

The results were a record year for Bank operations, as the total active portfolio of Board approved operations at the end of 2007 reached SDR 830 million, signings (commitments) stood at SDR 633 million, and amounts disbursed and outstanding were at SDR 474 million. These figures represent increases of 43%, 38% and 59% respectively, compared to end 2006 outturns, and they also exceed original projections for 2007. As a result of the Bank's increased operational activity, income before provisions grew 17% to SDR 14.8 million relative to 2006, with net profits reaching SDR 9.1 million.

These outcomes were a direct consequence of the large expansion of operational activity. During 2007, BSTDB approved 44 new banking operations for SDR 430 million, a 2, 3-fold increase in volume terms on outturns for 2006. Similarly, commitments (signed operations) increased 2, 7 times over 2006 as 35 new operations were signed for SDR 312 million. This expansion represented a direct result of the fulfilment of the objectives of the updated Business Plan and was made possible by a combination of internal factors, including more pro-active marketing efforts on the part of the Bank, but also by the fact that many banks and firms in the region found great value in the ability of the Bank to offer benefits such as provision of long term financing, country risk mitigation, networking benefits, and access to broader resource mobilization, among others.



Another key highlight of 2007, beyond the record growth in banking operations, was the capital increase approved by the Bank's Board of Governors (BoG) in December. The BoG approved a three-fold increase in the authorized capital of the Bank to SDR 3 billion, while the subscribed capital offered to the existing shareholders was doubled to SDR 2 billion. Key reasons for the approval were the recent track record of the Bank, the growth and diversification of operational needs in the region, and the need to reinforce the ability of the Bank to promote regional cooperation through investment, trade and economic collaboration. Above all, it is a forward looking decision which took stock of recent accomplishments and projected the potential of the Bank to fulfill future needs.

The capital increase will have significant and positive impact on the Bank and its operations in coming years. It is a powerful statement of the confidence of the Bank's shareholders in the institution, its achievements, and even more importantly its prospects for the future.

With the increase in resources and the enhancement to the operational capacity of the Bank, expectations and responsibilities will be accordingly greater. It will make the Bank more competitive in its pursuit of operations with high economic development and regional cooperation impact. It will also enhance the credit standing of the institution so as to make it possible to raise and in turn to offer financing more cheaply, with the ultimate benefit accruing to the Bank's clients- private banks, firms and official agencies of the Black Sea Region who will be able to access improved financing terms. This latter feature may prove particularly important should global financial uncertainties linger, helping Bank clients to obtain recourse to solutions in a constrained international setting.

A related issue is the increasing imperative to leverage shareholder resources to attract greater financial flows to the region. Thus, mobilization will be a key theme for 2008, and in particular increasing the mobilization of resources for the benefit of the Black Sea Region and its firms and banks. To this end, financial resource mobilization will take at least three forms: (i) the Bank will seek to undertake higher levels of borrowing in the markets (ii) it will intensify efforts to co-finance with other financiers in order to achieve greater leveraging via its own presence and secure higher levels of participation by external actors, and (iii) it will search for grant and other donor resources to facilitate innovative, possibly riskier but high potential impact operations.

After years of rapid growth, the Black Sea Region is poised to move into a more mature phase of development, with regional economies increasing in sophistication and complexity. Combined with the uncertainties in the global economic environment, this ensures that the Bank, along with governments, banks, and firms and other core economic actors active in the region, will face a growing set of challenges in carrying out their activities, as well as an expanding number of opportunities to engage and a broadening range of means, products and processes via which to meet the challenges and pursue the prospects. Openness of mind, willingness to confront risks and create new possibilities, and the flexibility to adapt to the changing circumstances will continue to constitute key elements of the Bank's operational strategy.

Hayrettin Kaplan  
President,  
Chairman of the BSTDB  
Board of Directors



# Highlights of 2007

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The BSTDB Board of Governors approved an increase in the authorised capital of the Bank from SDR 1 billion to SDR 3 billion (approx. USD 4.8 billion). The Board of Governors additionally authorised the offering of SDR 1 billion for subscription by the existing 11 Member States, thus increasing the subscribed capital to SDR 2 billion.

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Once again the Bank demonstrated an improving financial performance in 2007 as operating income increased by 15% to SDR 26.04 million (USD 41.10 million).

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Outstanding operations showed a 60% increase to a total of SDR 474 million (USD 750 million) while 35 new operations were signed for a total of SDR 312 million (USD 493 million).

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Business development in smaller member countries remained an operational priority for 2007, resulting in an increase in approved operations, particularly in Armenia, Azerbaijan and Moldova, of over 60% from 2006.

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Following the decision to increase the authorized capital and taking into consideration the Bank's strong performance Moody's Investors Service changed the outlook for the BSTDB credit rating of Baa1 from stable to positive.

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The Bank signed a Joint Corporate Governance statement with 30 leading development institutions in October 2007 in Washington. Promotion of the principles of good governance and transparency in the region is an important part of the BSTDB mission as a development institution.

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In cooperation with peer institutions, BSTDB enhanced its knowledge base with a number of benchmarking resources, which include comparative evaluation studies on IFI loan pricing, performance management advancements (balanced scorecard), capital increases, as well as lessons learned in a wide range of project sectors.

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BSTDB was the first International Financial Institution to hold its Annual Meeting of the Board of Governors and associated Black Sea Business Day in Chisinau under the auspices of the Government of Moldova. The Black Sea Business Day, inaugurated by the Prime Minister of Moldova attracted representatives of the regional governments and business community, as well as IFIs and international investors active in the region.

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Rotation took place in the BSTDB top management. Mr. Andrey Kondakov (Russia) was appointed as Vice President Banking in July 2007 for a three year period. Likewise, Mr. Vitalii Mygashko (Ukraine) assumed the duties of Vice President Operations in October 2007.

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Demonstrating support and commitment of the host country to the development of the BSTDB, the Government of the Hellenic Republic reimburses to the Bank all rental payments in relation to its premises in Thessaloniki through a Special Management Fund.



# **Economic Overview of the Black Sea Region:**

**TRENDS IN DEVELOPMENT,  
INVESTMENT AND TRADE**

Continuing the trend of recent years, the greater Black Sea Region- that is, the member states comprising the Black Sea Economic Cooperation (BSEC)- enjoyed another year of high economic growth during 2007, against a background of an improving business environment and general macroeconomic stability<sup>1</sup>. As Figure 1 shows, real GDP growth for 2007 reached an estimated 6.7%, slightly down from 7.1% in 2006. More importantly, it represented the sixth consecutive year of high growth of at least 5%, and helped to

boost the average annual rate of growth since 2000 to 6.0%. This outstanding performance, in turn, denotes a cumulative real economic expansion of 60% during this period, in which living standards have risen, poverty rates have dropped, trade and investment have picked up, and societies have been transformed into dynamic fast growing places of growing sophistication and increased integration into the broader European economy as well as the global context.

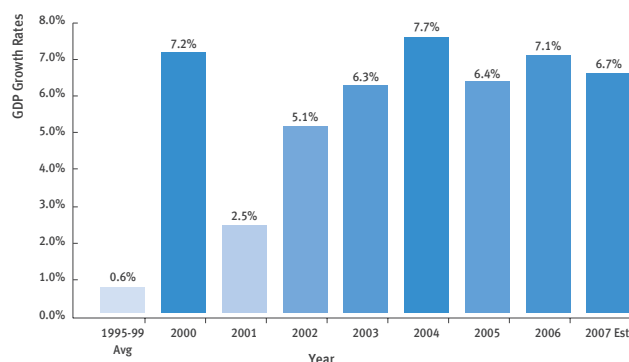


Figure 1: Black Sea Region Growth Trends

The greater Black Sea Region performance has outpaced that of neighboring regions and appears as one of the highest in the overall global context. For example, Black Sea Region growth was two and one half times higher than that of the region's principal trade and investment partner, the European Union, whose 27 members (including Bulgaria, Greece, and Romania) as a whole experienced estimated growth of 2.9%, while the performance of the Eurozone member countries (of which Greece is a member) was slightly weaker, at 2.7%. The Black Sea Region growth also

compares favorably with the relatively faster growing 2004 EU Entrants from Central-Eastern Europe and the Baltics<sup>2</sup>, despite the fact that the latter grew at a relatively brisk 6.1%. Overall, the Black Sea Region grew at nearly twice the rate of the World Economy, and as a region only lagged behind the developing regions of East Asia and Pacific (10.0%), and (ii) South Asia (8.4%), two regions which benefited respectively from China's and India's continued exceptional outturns. See Figure 2.

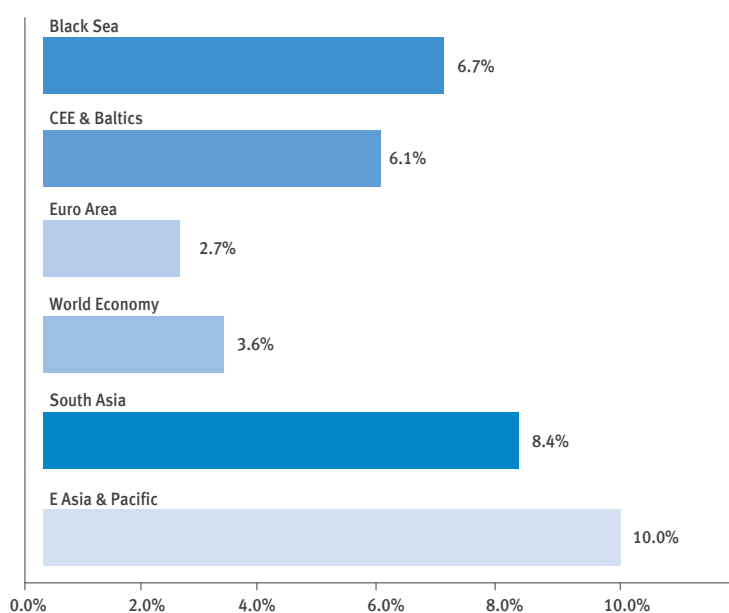


Figure 2: Comparison of Global GDP Growth for 2007, by Select Region

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 2008 of the World Bank (& GEP 2007), and the Economist Intelligence Unit. As many figures represent estimates for 2007, actual final figures may differ in detail, but the overall trends discussed in this section would not be altered.

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

Significantly, the sustained growth observed in the Black Sea Region has taken place against a background of stability and generally prudent macroeconomic policies. To varying degrees, Black Sea countries undertook difficult steps towards structural reform and macroeconomic stabilization in the late 1990s at a time of severe economic difficulties, frequent crises, and negative external perceptions. The often painful, yet necessary steps, paved the way for the subsequent period of growth by helping (i) to bring fiscal deficits under control, (ii) to reduce inflation to manageable levels and to eliminate or mitigate inflationary expectations, (iii) to restore external balances, and (iv) to implement reforms which improved the business environment, facilitated the creation and expansion of enterprises, reduced unemployment, and generally boosted the role and standing of the private sector.

As Table 1 shows, BSEC countries maintained the benign macroeconomic environment

during 2007, even though there was a general jump in inflation, mainly on the back of global factors such as volatile energy prices and a sharp increase in food prices. An important characteristic shared by all is that despite their diversity in terms of size, population, geography, economic structure, and income levels, growth was positive in each Black Sea country for the sixth consecutive year (dating back to 2002). Most countries were at the level of, or slightly higher than, the robust outturns of previous years although in certain cases there have been internal shifts in the contributing factors to growth. Whereas in years past export growth and private investment were key drivers of growth, their relative importance diminished in 2007 while domestic demand grew even further as a key contributor to the observed growth rates. In particular, increased capital inflows, buoyant tax receipts, sharp credit growth and increased wage levels have all contributed to sizeable increases in government spending and especially private consumption.

	GDP Growth	Avg. Inflation	Budget / GDP	Cur Acct Bal / GDP
Albania	6.0%	2.9%	-3.3%	-10.1%
Armenia	13.7%	4.0%	-1.6%	-3.0%
Azerbaijan	25.0%	16.7%	-5.5%	25.3%
Bulgaria	6.2%	8.4%	4.8%	-21.6%
Georgia	12.4%	9.2%	-0.3%	-15.7%
Greece	4.0%	2.9%	-2.8%	-14.1%
Moldova	3.0%	12.3%	-0.3%	-15.2%
Romania	6.0%	4.8%	-2.5%	-14.0%
Russia	8.1%	9.0%	5.4%	5.9%
Serbia	7.5%	6.5%	2.8%	-11.6%
Turkey	4.5%	8.8%	-1.7%	-5.8%
Ukraine	7.3%	12.8%	-0.8%	-4.1%

Table 1: Summary of Key Economic Indicators for 2007, by BSEC Member Country

This has led to concerns about overheating in some of the Black Sea economies and consequentially questions about the sustainability of the observed growth of recent years. After several years of declining trends, region-wide inflation rates rose and budget deficits nudged upward, while current account deficits in some cases also mushroomed during 2007. These overheating concerns coincide with global developments that have heightened uncertainties and raised worries that a global slowdown, or even recession, may

be imminent. Energy and other commodity prices have been volatile, while the financial crisis in the United States which began in the summer of 2007 has subsequently expanded and raised fears of contagion across not just countries but also markets.

While these reversals bear careful monitoring, they do not signify an end of growth, nor an impending crisis. Rather, the confluence of worrying regional indicators and global uncertainties are mainly warning signals,

and indications that the cycle of growth may have entered a mature phase, requiring greater prudence and quite likely some policy adjustments such as greater fiscal restraint, re-allocation of expenditures, tighter monetary policy, closer regulation of financial institutions, or targeted structural reforms to eliminate lingering distortions in particular sectors of the economy. Significantly, the track record of the region's economies in tackling such problems has been positive since 1999, and the region has proven resilient to exogenous and endogenous shocks during this period, whether they have been financial, economic, or geopolitical.

There are additional problems which Black Sea countries are facing. Structural reforms are still needed in many sectors, with energy and especially, agriculture, ranking as the most difficult. The existing state of infrastructure is also emerging as a potential constraint on growth. For while the private sector is booming in most countries, and levels of financing for investment and trade are surging, the energy and transport infrastructure required to support the increased flows of goods, services, and people is lagging. And while the fiscal situation is healthier today than in the past, meeting new infrastructure requirements threatens to overwhelm fiscal capacity.

These are real issues, and they require careful attention on the part of policymakers and the international financial community. Fundamentally though, it needs to be kept in mind that these are problems of success, and that they represent a dramatic turnaround relative to where things stood a decade ago.

Once again, special attention is due to the 'smaller' economies of the Black Sea Region - defined as those with all of the following characteristics: population under 10 million, GDP under USD 40 billion, and per capita incomes under USD 4000. These are also 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 in the region during the 1990s. In addition, due to their small size and geographic location, they have suffered disproportionately greater perceptual 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.

Five such economies exist in the Black Sea Region and three of them experienced real GDP growth above 10%, led by Azerbaijan which recorded its third consecutive year of growth of 25% or higher, and Armenia, which enjoyed double digit growth for the sixth consecutive year. Georgia registered 12.4% real GDP growth, while outturns for Albania and Moldova were more modest, at 6% and 3% respectively. Collectively, they have been the fastest growing countries in the Black Sea Region in recent years, and their average growth rate of 16.6% for 2007 was more than double the overall regional growth rate of 6.7%.

The average annual growth rate of these countries since 2000 has been 11.4%, ahead of the region's 6.0% 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. See Figure 3 for year by year data.

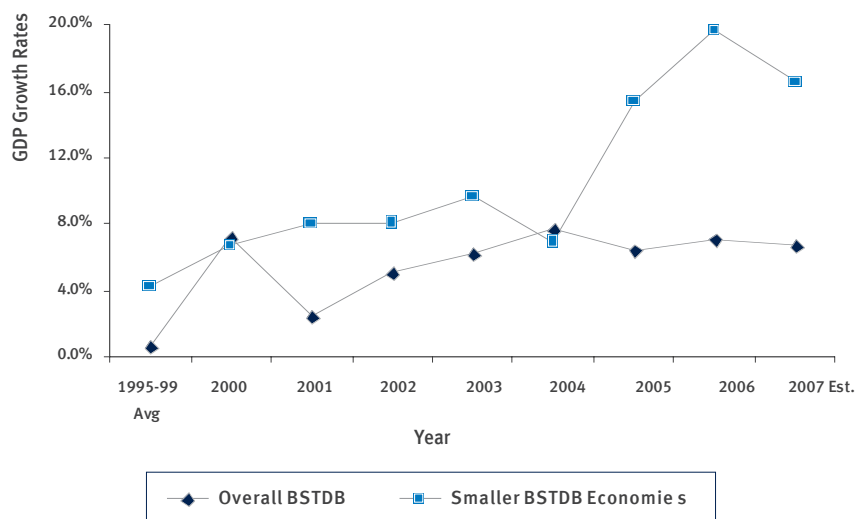


Figure 3: GDP Growth of Small Black Sea Economies vs. All Black Sea Region

The sustained growth across the region has translated into rapidly growing income levels (See Figure 4). Per capita incomes have increased across the board, with the regional average having more than tripled in seven years in dollar terms, from roughly

USD 2300 in 2000 to an estimated USD 8300 in 2007. The weakening dollar has inflated these measures to some degree, however, the real growth is substantial and represents real improvements.

The increase in incomes is corroborated by other indicators, such as poverty rates which have decreased sharply, while key measures of quality of life, such as health and education statistics, have shown improvements. It is also matched by data on average wage levels, with all countries (except Greece and Turkey) experiencing at least a tripling of average real wages- and in some cases much greater increases.

Such figures have their limitations in terms of calculation and underlying meaning, as they do not always reveal inequalities that exist in the societies, such as urban/ rural splits, rising income disparities, and uneven distribution of growth and prosperity across societies. Nonetheless, they do reflect a genuine rise in overall living standards throughout the region.

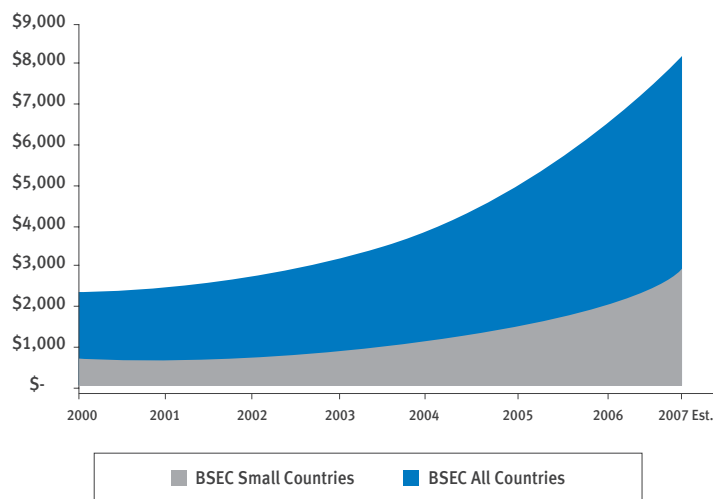


Figure 4: Black Sea Region Per Capita Income Patterns 2000-2007

## Investment and Trade Flows and Regional Cooperation Trends in the Black Sea Region

For the Black Sea Trade and Development Bank, and the entire family of institutions that make up the Black Sea Economic Cooperation (BSEC), supporting economic development and promotion of regional cooperation represent two core objectives of their operating mandate. The previous section outlines economic developments in the Black Sea Region during 2007, in the context of global growth, compared to historical trends, and by looking at structural features of the performance.

Assessing the second part of the mandate, trends in regional cooperation and economic integration, is considerably more difficult albeit no less important. One of the problems is that assessment of such a trend requires analysis across a suitably lengthy period of time, so as to be able to distinguish between trends and one-off events, or the volatility of particular years. A second concern is what

data to use to make such an assessment. No one set of indicators will give a definitive answer, and even then depending on how data is measured or presented, widely differing conclusions may be drawn.

From a review of sources such as press articles, interviews with businessmen and officials, and academic articles, among others, it is possible to assert that integration is moving ahead. Figures on the movement of population suggest that migration from one country to another within the Black Sea Region is high, dating back to the 1990s, and significant portions of the labor force of one country are currently gainfully employed in other member countries. Temporary movements back and forth across countries are also high, while tourism has increased in recent years due to (a) the increased prosperity which makes vacations possible for a greater



portion of the population, and (b) the targeted effort by some countries to expand tourism and attract visitors from neighboring countries.

Financial flows among BSEC countries appear to be increasing as well. The region's migrants send home significant levels of remittances, amounts which represent the largest source of external financing for

countries which lack access to international capital markets and have not attracted large levels of assistance or investment. More formal financial flows and cross-country lending also appear to be increasing, an observation corroborated by the high profile acquisition of financial institutions in one member country by banks based in another member country in 2006 and 2007.

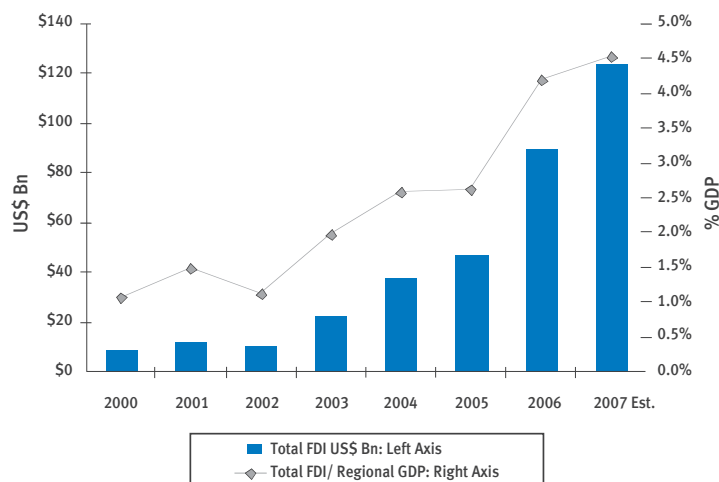


Figure 5: Foreign Direct Investment in the Black Sea Region 2000 - 2007

Data on foreign direct investment (FDI) and international trade represent two standard measures of financial flows, although they each have limitations. In the case of FDI, decent figures on volume of inflows are available quickly, but it is often difficult to establish the origin of the flows. This in turn makes assessments of intra-regional investment flows more difficult although available evidence during 2007 suggests that intra-regional investment likely followed the general trend of booming foreign direct investment flows, with Greek, Russian and Turkish firms continuing to lead the way in making acquisitions or green-field investments in other Black Sea countries.

Irrespective of origin, Figure 5 shows the favorable trend in foreign direct investment in the Black Sea Region between 2000-2007, with the level of FDI as a share of GDP having increased four times in 2007 relative to 2000. In absolute terms, the numbers are even more impressive, as FDI into the region has increased fifteen-fold from USD 8.1 billion in 2000 to an estimated USD 122.8 billion for 2007. Relative to 2006, FDI in 2007 increased 38%, but because regional GDP is also growing rapidly, this resulted in a smaller increase in the level of FDI as a share of GDP from 4.2% to 4.5%.

Perhaps more significantly, 2007 marked the first year during which FDI into the Black Sea Region (as a

share of GDP) reached and even exceeded the level attracted by the eight 2004 EU Entrants from Central-Eastern Europe and the Baltics who have been lauded for their achievements in attracting FDI. The CEE and Baltics attracted FDI inflows amounting to 4.2% of GDP, a marginal 0.13% less than the Black Sea Region. This represents a significant symbolic accomplishment for the Black Sea Region, demonstrating that after years of continuous increases in amounts of FDI attracted, it has attained a footing on a par with a highly successful set of comparator economies which have enjoyed the added benefit of EU membership (which applies to only three BSEC member states) and the boon to investment which EU accession had provided. While Romania and Bulgaria, as new EU members, enjoyed high levels of FDI, countries as varied as Georgia, Russia and Turkey also attracted record levels of FDI, with other BSEC countries maintaining robust inflows.

International trade flows show how trade among countries is evolving, and over time can reveal useful tendencies. Despite certain limitations<sup>3</sup> -for purposes of a first approach analysis to the nature of trade in and within the Black Sea Region- trade figures over a suitable period of time can suggest certain patterns, or at least hypotheses about trends that may be further explored. Bearing in mind the caveat, data on intra-regional trade flows is presented in Figure 6.

3. Trade figures are often incomplete as well as unreliable. On the one hand, much trade goes unrecorded, although this is a trend which has diminished somewhat in recent years as informal suitcase trade and smuggling have declined, while recorded trade has increased. On the other hand, figures between countries do not match. More often than not the data which Country A shows for exports and imports with Country B bear no resemblance to the data Country B shows for trade with Country A. As a result, Black Sea Region trade figures consistently show that the Region is running a deficit with itself.

The figure displays measures of Black Sea Region's trade in two ways first, how intra-Black Sea trade is evolving as a share of total trade, and second, how intra-Black Sea trade is evolving as a share of GDP. The first indicator measures the extent to which trade among Black Sea countries is increasing relative to the external trade of Black Sea countries. It provides insight into the orientation of the external trade of the Black Sea Region, specifically how trade among Black Sea countries compares to their trade with non-regional countries. The second indicator offers more general information about how intra-Black

Sea trade is evolving with respect to, and its relative importance with respect to, the overall size of the Black Sea economies. The combination of these indicators is necessary because it is possible for the share of intra-BSEC trade in overall trade to be growing if overall trade is declining by a greater amount than intra-BSEC trade, while it is also possible for intra-BSEC trade to appear to be growing, but at a rate lower than overall GDP growth, such that its importance for the economies of the Black Sea Region is actually declining.

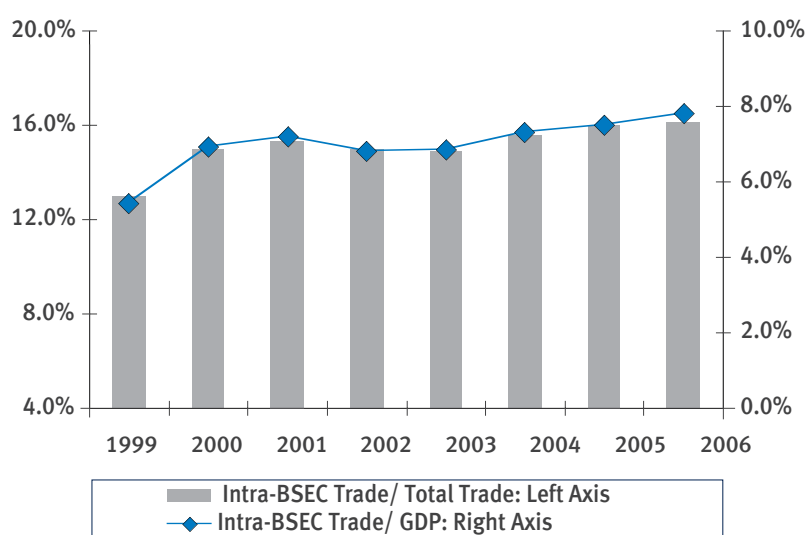


Figure 6: Intra-Regional Trade Flows in the Black Sea Region 1999 - 2006

Recorded trade among Black Sea countries in dollar terms increased 352% in value between 1999-2006 from USD 36.2 billion to USD 163.5 billion. This figure is likely inflated by factors such as increased energy prices and the decline in the value of the dollar, but it still exceeds the increase in the nominal GDP of the Black Sea Region over the same period, which increased 215% in dollar terms. It also exceeds the rate of increase of total international trade of Black Sea countries, which increased by 264%, from USD 278.2 billion to USD 1,012.1 billion.

As a result, both measures in Figure 6 are rising trade among Black Sea countries as a share of GDP from 5.4% to 7.8%, a rise which appears modest and from low beginning levels. Nevertheless, this translates into an increase of 43% and suggests that the pace of trade among Black Sea countries is grow-

ing more rapidly than the region's economy. At the same time, the share of trade among Black Sea countries as a share of total trade turnover has increased moderately from 13.0% to 16.2%. Again, this represents a trend which begins from a low base, but the 3.3% gain by intra-Black Sea Region trade in the share of total trade entails an increase of over 24%. Moreover, the rate of increase has been steady since 2002. While the total trade turnover of Black Sea countries as a share of GDP between 1999-2006 has increased by about 15% (from 41.8% to 48.3%) the increase in the share of intra-regional trade indicates that trade links and economic cooperation in the Black Sea Region are on a gradually rising trend.

Further breakdown of the figures reveals that the increase is more pronounced in Albania, Bulgaria, Greece, Romania, and Turkey - the

countries which are EU members, are candidates for EU membership, or have a membership perspective. They are trading among themselves at an increasing rate, but they are also trading with other members of BSEC at a higher rate, and they thus account for most of the observed increase in BSEC trade.

By contrast, Armenia, Azerbaijan, Georgia, Moldova, Russia, and Ukraine have shown smaller increases in the level of trade among themselves, although their trade with the other BSEC members is growing at a faster rate and thus accounts for most of their increase in BSEC trade.

However, geography, and the centrality of location relative to other trading partners may be a factor as well. By any measure, Turkey is the main driver of increased trade in the Black Sea Region, as it has significantly increased its trade with the Black Sea countries as a share of GDP and as a share of total trade turnover, in excess of the regional averages (43% and 24% respectively). Georgia, which is a much smaller economy, is the only other country for which the rate of increase of both measures exceeds regional averages. By contrast, countries like Albania, Armenia, Azerbaijan, Russia and Moldova exhibit increases below the regional averages for each measure. This means that while their overall trade with other Black Sea countries is increasing, it is doing so at a lower rate than their trade with non-Black Sea countries and less than the rate at which their economy is expanding, thus making it appear that the relative importance of intra - Black Sea trade is decreasing.

However, closer inspection reveals that only in the cases of Armenia and Russia there is a decline in the share of intra-Black Sea Region trade as a share of GDP. Moreover, the case of Azerbaijan demonstrates the complexity, but also the importance, of looking at data from a number of different angles, and compiling a range of measures before drawing conclusions. On the one hand, due to its extraordinary growth in overall trade and GDP levels, its commerce appears to be re-orienting away from the Black Sea Region, with the share of its trade volume with Black Sea countries declining nearly 30%. On the other hand, Azerbaijan's trade with other Black Sea countries increased 407% between 1999-2006, a rate exceeded only by Turkey and Georgia, the two 'champions' of increased Black Sea trade integration.

These non-intuitive patterns suggest that while helpful, even the combination of the Black Sea Region's share of trade as (i) a share of total trade turnover and (ii) a share of GDP, are but two pieces that contribute to, but do not yet provide, a complete picture. Nevertheless, these indicators, and the timeline from 1999-2006 suggest that while Black Sea countries are still re-orienting their trade patterns, with the European Union and/or centrality of geographic position playing a more prominent role in many cases, they are also discovering - or in some cases rediscovering- trade links with neighbors who may or may not historically have been major trading partners. The effect, such as it exists, is positive and has shown steady growth for a few years, but because overall levels remain modest it is premature to make definitive projections for the future, nor can reversals be completely discounted in the event of shocks, with significant economic impact, occurring.



# **BSTDB in the Black Sea Region**

**OVERVIEW OF OPERATIONAL  
PRIORITIES AND PRODUCTS**

## Operational priorities

The Bank employs its capital structure, relations with member countries governments and knowledge of the region of operation to foster development by focusing on:

1. financing projects, programs and commercial activities
2. information sharing, promotion of the region, development of networks, and other knowledge dissemination activities and
3. promoting institutional development and capacity building

The Bank seeks to mobilize domestic and foreign resources into the region and to ensure that its operations are tailored to meet specific country needs, while applying sound banking principles and maintaining high portfolio quality. Cooperation with other international organizations and development finance institutions plays a significant role.

It targets a portfolio composition well balanced between large corporations, banks, sovereign and sub-sovereign clients, and medium size companies, with whom the Bank may establish direct working relationships. In addition to large, relatively good credit risk, companies, the Bank expands assistance, gradually and cautiously, to firms which are less well established, less well known, and with a shorter track record, in order to achieve higher development impact. The Bank also targets clients in the public sector, including municipalities, public utilities and public agencies.

The Bank's capacity to invest in operations with high development impact has been continuously enhanced, in particular with reference to operations aimed at promoting the SME sector, certain private sector operations in small shareholding countries, and public or publicly guaranteed operations (e.g. municipal infrastructure).

Establishment of long lasting relations with well performing clients, in order to expand activity while controlling cost of identification of new business opportunities, is a priority for the Bank.

Furthermore, the Bank increasingly focuses its business development and marketing efforts on identifying cross-country operations, particularly in infrastructure related sectors. Such operations possess high shareholder value for the Bank and are therefore priority activities.

The sector priorities differ by country, and are specified in detail in the country strategies. Other sectors may be addressed as well, especially where they contain high development benefits and/or cooperation prospects.

## Products

Satisfying client needs requires a creative approach whereby the distinction between project, corporate and trade finance is abandoned and focus shifts to offering clients mixed and structured financing packages.

The Bank offers clients the products described and approved in the Portfolio Risk Management and Investment Policies, either on a stand alone or structured basis. Tailored products to meet specific client needs are considered by the Bank where appropriate.

The Bank envisages utilization of existing products (e.g. loans, equity and quasi-equity, guarantees) and development of new products, offered to its clients either separately or in any combination thereof.

The terms of the Bank's products are tailored to meet the specific requirements of each client and operation and may be adjusted throughout the term of the operation. Such adjustment may, if so provided in the original documentation, extend to the conversion of one product type to another during the life of an operation.

### Selected BSTDB Financings in 2007

#### JSC Seventh Continent, Russia

BSTDB extended a USD 36 million corporate loan to Seventh Continent, a Russian supermarket chain.

The proceeds will enable Seventh Continent to modernize its existing retail super- and hypermarkets network and to upgrade its information technologies and store equipment in Moscow, St. Petersburg, Rostov-on-Don and other cities.

JSC Seventh Continent was established in 1994 in Moscow and today has become one of the leading Russian national chains. It operates supermarkets and hypermarkets offering a wide assortment of food and non-food products at competitive prices in convenient locations. The company employs approximately 11.900 people in major regions of the Russian Federation. Among its strategic priorities are the expansion of hypermarkets to cities of more than 500.000 inhabitants, the improvement of its product mix and the introduction of discount programmes for its clients.

The operation has a significant employment effect with retail trade being a labor intensive market. The operation will not only contribute to the development of the food distribution system in Russia, but will also bring - in additional export opportunities for the agribusiness sectors of Armenia, Bulgaria,

Georgia, Moldova and Ukraine, producers of these countries being major suppliers of agri-products to the Russian Federation.

**Amount:** USD 36,000,000  
**Type of Financing:** Corporate Loan  
**Maturity:** 3 years

#### CJSC Euroterm, Armenia

BSTDB provided a EURO 3 million secured term loan to CJSC Euroterm, for financing capital expenditures related to modernization of the company's production and packaging equipment, investments in cultivation of fruits and vegetables, and working capital.

This facility will contribute to the development of Armenia's food processing industry and the agribusiness sector of the country.

CJSC Euroterm is one of the leading producers of fruit juice, fruit concentrates and canned fruits and vegetables in Armenia. Euroterm is also active in assembling and distributing heating systems for commercial and residential properties. The Company sells its products both domestically and to foreign customers.

**Amount:** EURO 3,000,000  
**Type of Financing:** Corporate Loan  
**Maturity:** 5 years

The Bank has three types of operations:

1. *Direct operations* used for most project /corporate finance operations mainly in the commercial sector but also in certain cases in the financial sector.
2. *Intermediated operations* used for increasing outreach capacity for SMEs, micro-enterprises, most trade finance operations and certain operations in the financial sector.
3. *Syndicated transactions*, most desirable in three instances:
  - a. large value cross country project finance operations, where other IFIs are involved
  - b. large value low risk transactions that have good return opportunities, as a means to generate resources to apply to smaller or riskier operations with high development impact and
  - c. excess liquidity- syndications with co-financing partners would act as a fund utilization solution.

Options (b) and (c) above are “auxiliary operations”- e.g. lower priority operations - mainly used to “smooth out” temporary fluctuations in operational development, and to provide adequate resources for “cross-subsidization”. Such cross-subsidization, aimed at enhancing the development impact of Bank financed operations, implies in part the use of resources generated by “auxiliary operations”, to compensate to some extent for the higher cost and lower return of certain Bank operations in infrastructure, or which are important for the public interest.

#### Selected BSTDB Financings in 2007

##### **Alfa-Nafta (ANP), Ukraine**

BSTDB provided a USD 36 million loan to finance the network expansion of NK Alfa-Nafta (ANP), a Ukrainian retail and wholesale petroleum and gas operator. The BSTDB financing will also facilitate the construction or purchase of new gas stations, the maintenance of oil products supply and the organizational restructuring of the company in preparation for its IPO in the next 3-4 years.

The operation is expected to have a solid regional cooperation impact servicing international transportation flows through Ukraine and financing imports of petroleum products from neighboring countries like Russia and Romania. The development impact for Ukraine includes better utilization of the local refineries and consolidation of the country’s fuel supplier’s position in the region.

**Amount:** USD 36,000,000  
**Type of Financing:** Long-Term Loan Facility  
**Maturity:** 7 years

##### **Lomisi, Georgia**

A 7-year loan of USD 5 million was provided by BSTDB to JSC Lomisi, a fast-growing Georgian beer manufacturer, for financing its investment programme.

The BSTDB funding was used to expand the production capacity and improve the production process (better quality control etc.).

Confirming the potential of Lomisi for further growth, Efes Breweries International N.V. acquired in March 2008 all the shares of the company from EBRD and three Georgian shareholders. This landmark foreign direct investment in Georgia enhances significantly the company’s prospects.

**Amount:** USD 5,000,000  
**Type of Financing:** Corporate Loan  
**Maturity:** 7 years (including 2 year grace period)

## Co-Financing

The Bank values its cooperation with other financiers in mobilizing investments in the Black Sea Region and realizing cross-country operations, particularly in infrastructure related sectors. Such operations possess high shareholder value for the Bank and are therefore priority activities.

In 2007 the Bank co-financed 10 operations, including the Istanbul Metro, Avea, Zolotaya Semechka, Nizheserginskiy, Ukrainian Railways, Expobank, Industrial Union of Donbass, and Alumil, for a total amount of USD 335 million. 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), KfW Banking Group (Germany), SECO (Switzerland), Netherlands Development Finance Company (FMO), Norfund and Finnfund in Scandinavia,

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, Bayerische Hypo-Und Vereinsbank AG, WestLB AG London, Turkiye Vakiflar Bankasi, Banca OPI S.p.a., Standard Bank, Fortis Bank SA/NV, Landesbank Hessen-Thuringen Girozentrale, Societe Generale S.A., Bayerische Landesbank, Raiffeisen Zentralbank Osterreich Aktiengesellschaft, Turkiye Is Bankasi A.S. - Bahrain Branch, Turkiye Garanti Bankasi A.S., -Luxemburg Branch, Commertzbank AG, Kommunalkredi Austria AG, AKA Ausfuhrkredit - Gesellschaft mbH, ABN-AMRO Bank N.V. - London, ABN-AMRO Bank N.V. – Stockholm, SACE Spa - Servizi Assicurativi Del Commercio Estero, VTB Bank Europe PLC, VTB Bank (France) SA, VTB Bank (Austria) AG, Alpha Bank, Pireaus Bank, Eurobank, Commercial Bank of Greece, and corporations – Ericsson Credit AB, Nokia Corporation.

### Selected BSTDB Financings in 2007

#### Istanbul Metro and Light Rail Transport System, Turkey

BSTDB contributed USD 21 million, as a joint lead arranger, to a syndicated commercial loan of USD 310 million to the Metropolitan Municipality of Istanbul.

The loan will be used for the expansion of the metro and light rail transport system in Istanbul, a priority investment program of the Istanbul Municipality aimed at easing the serious traffic congestion problems in the city.

With a total cost of USD 532 million, the project involves the extension of the Otogar-Bağcilar light railway transport line and expansion of the metro line along Kirazlı-Ikitelli-Basak in the European side of Istanbul.

**Amount:** USD 21,000,000  
**Type of Financing:** Syndicated Loan  
**Maturity:** 8 years (including 2 year grace period)

#### Teleset, Russia

BSTDB provided a USD 20 million long term loan facility for general corporate purposes in support of network expansion of Teleset, a private telecom company in Tatarstan, Russia. The Bank has also taken a USD 3 million minority stake in the holding company consolidating the telecom related activities of the Teleset group in Russia.

The company is a returning client, which has already benefited from an earlier BSTDB loan and now requires more funding to finance expansion.

The Bank's financing will improve fixed line telephony services in the Volga region by providing access to low-cost internet and modern data transmission services to corporates and residential clients.

**Amount:** USD 23,000,000  
**Type of Financing:** Long-Term Loan Facility and Equity Financing  
**Maturity:** 7 years with 2 year grace period



## 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 800,000 and was replenished by Euro 500,000 in 2003. The Fund is tied to consulting companies based in Greece. However, up to 25% of an assignment cost may be allocated to consultants who are nationals of the Bank's other member countries.

Altogether, the Hellenic Fund has devoted around Euro 958,000 to consulting assignments since inception. Out of this amount Euro 887,000 were in fact disbursed. The sectors benefiting from these

funds have included manufacturing, telecoms, oil & gas, transportation, agribusiness and banking. These funds were distributed among nine member countries - Albania, Armenia, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, and Ukraine. In 2007 six assignments were funded in the amount of about Euro 188,000.

### Selected BSTDB Financings in 2007

#### Bank Center-Invest, Russia

BSTDB provided a USD 10 million subordinated loan with a tenor of 7 years to Bank Center-invest ("CIB"). This loan is classified as Tier 2 capital, and will strengthen the CIB capital base and facilitate its future business growth.

CIB ranks among the top 80 Russian banks in terms of assets and capital, enjoys the support of shareholders including the EBRD and DEG, and is a strong regional bank with a leading presence in the Rostov region of Russia's South Federal District.

The BSTDB loan will be instrumental in funding the development, branch network expansion and operational upgrading of CIB, strengthening its efforts to continue being the leading private bank in its region in line with the bank's strategic plan.

Through this operation, the BSTDB contributes to the long-term development of the Rostov region by supporting the business expansion of the region's leading financial institution. This will in turn have a positive spill-over effect to the region's SME clientele, local traders and many retail clients that are the market's most dynamic element of growth.

**Amount:** USD 10,000,000

**Type of Financing:** Long-Term Subordinated Loan

**Maturity:** 7 years

#### Technika Bank, Azerbaijan

BSTDB provided a USD 8 million 6 year loan to Technika Bank ("TB"), for financing mortgages. This funding is the first of its kind provided by an IFI to a local Azerbaijan bank with the purpose of financing residential mortgages and as such it is expected to have a high demonstration effect for both creditors and other local commercial banks.

TB is the fourth largest commercial bank in Azerbaijan with the largest network among the private banks. The strategic plan of the bank is to further increase its presence in Azerbaijan and to open a subsidiary in Moscow, Russia.

Through this operation the BSTDB targets enhancement of TB's mortgage lending capacity and by this route hopes to contribute to the improvement of living conditions for citizens. In addition, the operation will impact positively on banking sector competition strengthening regional development through the TB branch network and improving the liquidity profile of the recipient bank.

**Amount:** USD 8,000,000

**Type of Financing:** Long-Term Loan Facility

**Maturity:** 6 years with 1 year grace period

## Environment Protection

The Bank works in a very dynamic region with high growth rates and great potential for further economic development, but it is also a region that faces many environmental challenges. Given that, the Bank in its financing makes efforts to assist its clients in the private sector to improve their environmental performance to become “greener”- helping in this way the member countries to achieve a better state of environment and human well being.

It is also part of the Bank’s mandate, as a regional development institution, to promote environmental soundness and sustainable development in all its loan operations. Thus, the Bank seeks to ensure that all the potential environmental risks arising from any given operation that are likely to affect the state of the environment, human well-being and ultimately the Bank itself, are properly identified, assessed and mitigated. Environmental implications are analysed and efficient mitigation measures are proposed in the overall

decision-making process for each of the Bank’s commitments. 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 Bank’s 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.

### Selected BSTDB Financings in 2007

#### BSTDB Trade Finance Program for the Region

BSTDB continued to support the increasing intra-regional trade among the member countries, by raising its exposure to existing financial intermediaries and by establishing

##### Turk Eximbank, Turkey

**Facility Amount:** USD 36,000,000  
(increased from USD 23,000,000)

**Type of Facility:** Revolving Pre-Export Finance Facility

**Maturity:** Revolving, with maximum disbursement term of 180 days

##### First Ukrainian International Bank, Ukraine

**Facility Amount:** USD 18,000,000  
(increased from USD 10,000,000)

**Type of Facility:** Revolving Trade Finance Facility

**Maturity:** Revolving, with maximum disbursement term of 360 days

##### Cartu Bank, Georgia

**Facility Amount:** USD 1,500,000

**Type of Facility:** Revolving Trade Finance Facility

**Maturity:** Revolving, with maximum disbursement term of 360 days

relationships with new counterparties. In 2007, BSTDB trade finance facilities were extended to the following banks:

##### Inecobank, Armenia

**Facility Amount:** USD 6,000,000  
(increased from USD 3,000,000)

**Type of Facility:** Revolving Trade Finance Facility

**Maturity:** Revolving, with maximum disbursement term of 360 days

##### Bank Respublika, Azerbaijan

**Facility Amount:** USD 3,000,000

**Type of Facility:** Revolving Trade Finance Facility

**Maturity:** Revolving, with maximum disbursement term of 360 days

##### Kreditprombank, Ukraine

**Facility Amount:** USD 10,000,000

**Type of Facility:** Revolving Trade Finance Facility

**Maturity:** Revolving, with maximum disbursement term of 360 days

4. The total number of approved operations is 163, but two operations (SEAF - SME equity investment fund and Balkan Accession Fund) are split between three beneficiary countries in the first case and between five beneficiary countries in the second case.

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

## Portfolio Description

### Portfolio Structure at end 2007

Since the beginning of operations in June 1999, the Bank has approved 169 operations<sup>4</sup> totaling over SDR 1.3 billion, distributed as follows: 4 in Albania, 9 in Armenia, 15 in Azerbaijan, 19 in Bulgaria, 13 in Georgia, 9 in Greece, 9 in Moldova, 18 in Romania, 33 in Russia, 17 in Turkey, and 23 in Ukraine.

At the end of 2007 there were 99 Board approved operations in the active<sup>5</sup> portfolio for a total initially authorized amount of SDR 830 million. Of these, 83 operations had been signed. Still monitored in the active portfolio of the Bank are 82 operations for a total outstanding amount of SDR 474 million.

### Selected BSTDB Financings in 2007

#### Support for Leasing to Small and Medium-Sized Enterprises (SMEs)

Leasing is one of the most efficient financing tools for SMEs. With the objective of penetrating new markets by means of an innovative banking product, BSTDB cooperates with leasing institutions to deliver leasing products to the SMEs in the Black Sea Region. The SME Leasing Facility complements the Trade

Finance and SME products by reaching the SMEs and offering the advantages of the leasing financing scheme.

In 2007 BSTDB signed SME Finance Facilities with the following financial intermediaries:

#### NBD Bank, Russia

**Facility Amount:** USD 5,000,000  
**Type of Facility:** SME Finance Facility  
**Maturity:** 3 years

#### TBC Leasing, Georgia

**Facility Amount:** USD 3,000,000  
**Type of Facility:** SME Leasing Facility  
**Maturity:** 5 years

#### Europlan, Russia

**Facility Amount:** USD 18,000,000  
**Type of Facility:** SME Leasing Facility  
**Maturity:** 3 years

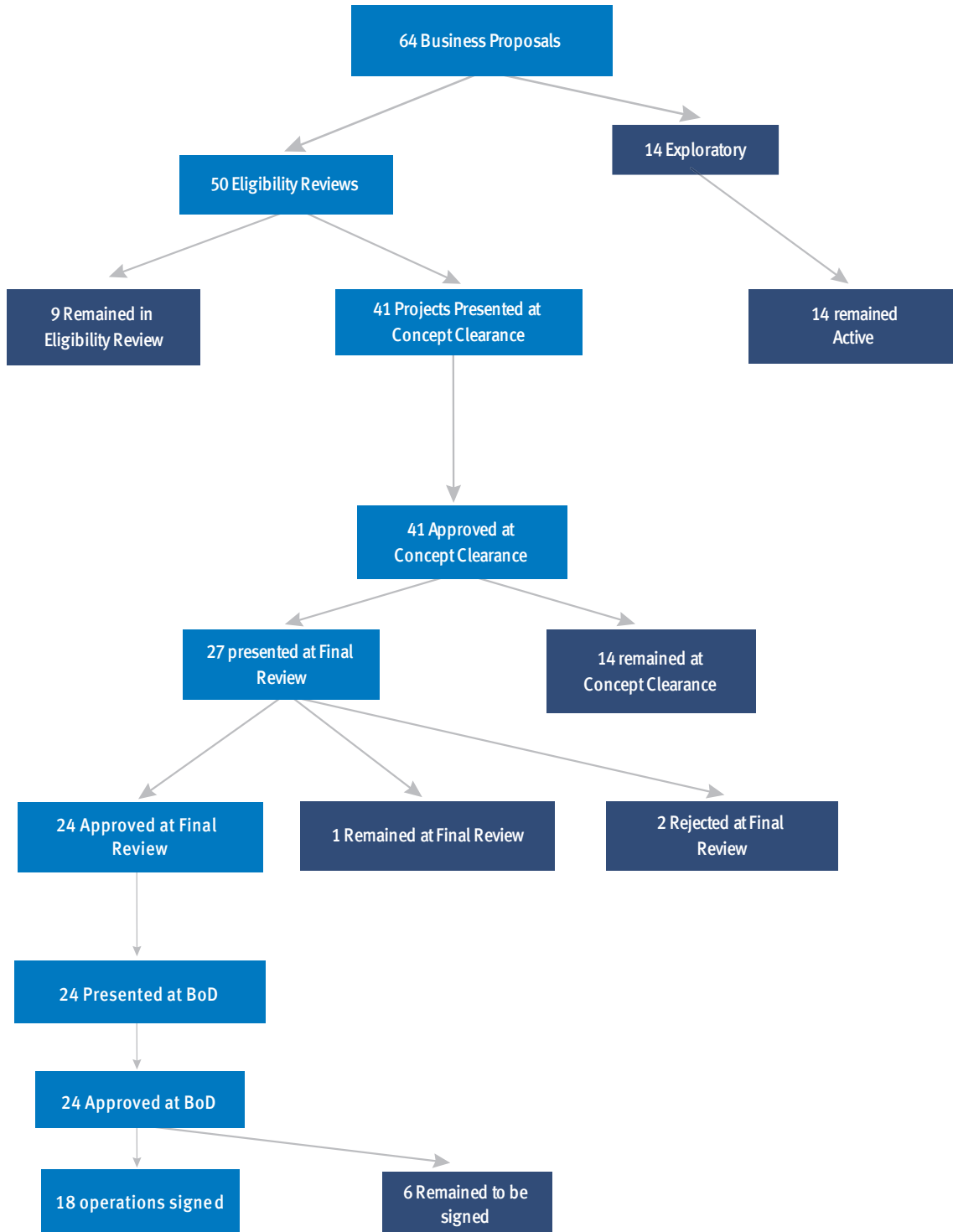
### Developments During 2007

The performance of the Bank in 2007 continued an improving trend. Income before provisions reached SDR 14.8 million, which would translate into a return on equity of around 4.6%. The cost/income ratio before provisioning declined to 42%, while operating income generated per operational staff increased to SDR 620,000. During the year the portfolio of operations maintained its high quality with no operation deteriorating to non-performing status.

In 2007 the outstanding portfolio of the Bank increased by 59%. This was the result of a highly intensive business development effort, which resulted in the signing of 35 operations 59% more than in 2006. The aggregate value of these signed operations was SDR 312 million higher by 167% than in the previous year. During the year the Board of Directors approved 44 operations with a total value of SDR 430 million.

As distinct from the above summary and referring only to developments during 2007, the Bank evaluated 64 business proposals, which went to the various phases of the operations cycle. Of these, 24 went through the entire operations cycle and were approved by the Board of Directors. 20 operations which were identified and went through various phases of the operations cycle in 2006 were also approved by the Board of Directors in 2007. Of the 64 operations identified in 2007, 14 operations are expected to be submitted for Board of Directors approval in 2008, while 6 already approved operations are expected to be signed in 2008. These developments are graphically expressed in the following diagram on the next page:

**Project Pipeline Statistics for 2007**



### Active Portfolio Structure by Country

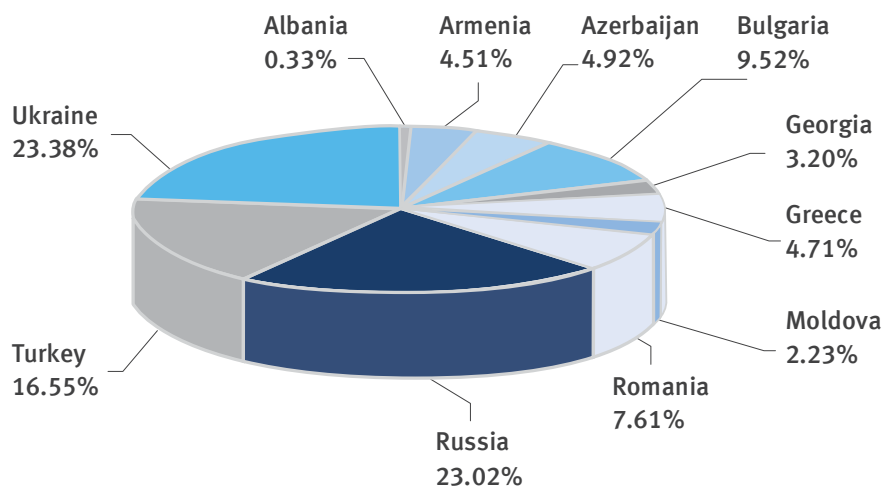
#### Approved Operations

There are currently 99 Board of Directors approved operations for a total amount of SDR 830 million.

Bulgaria, 8 in Georgia, 2 in Greece, 6 in Moldova, 6 in Romania, 21 in Russia, 8 in Turkey and 18 in Ukraine.

Out of the total number of operations 2 are in Albania, 8 in Armenia, 12 in Azerbaijan, 8 in

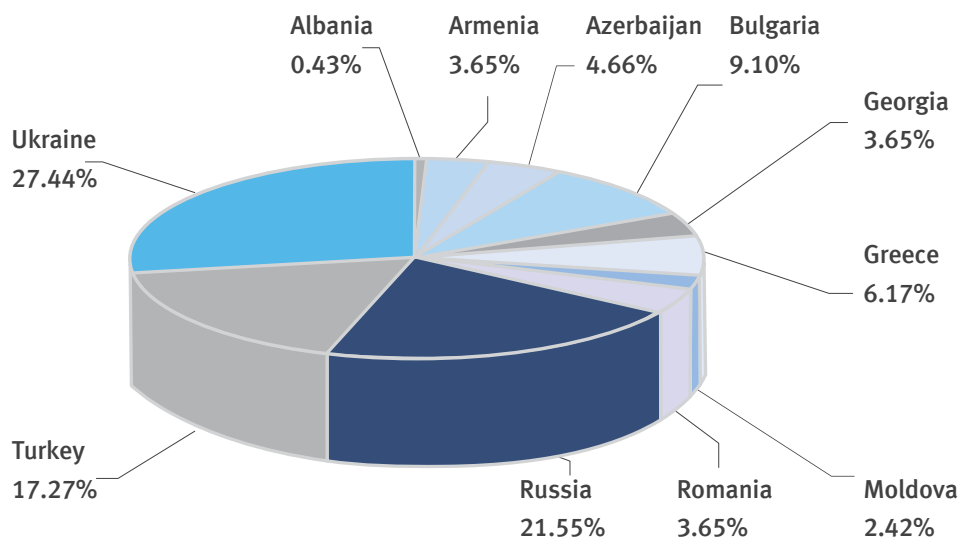
The distribution of the approved amounts by country is depicted in the following graph:



#### Signed Operations

Of the approved amount, 83 operations are signed for a total amount of SDR 633 million.

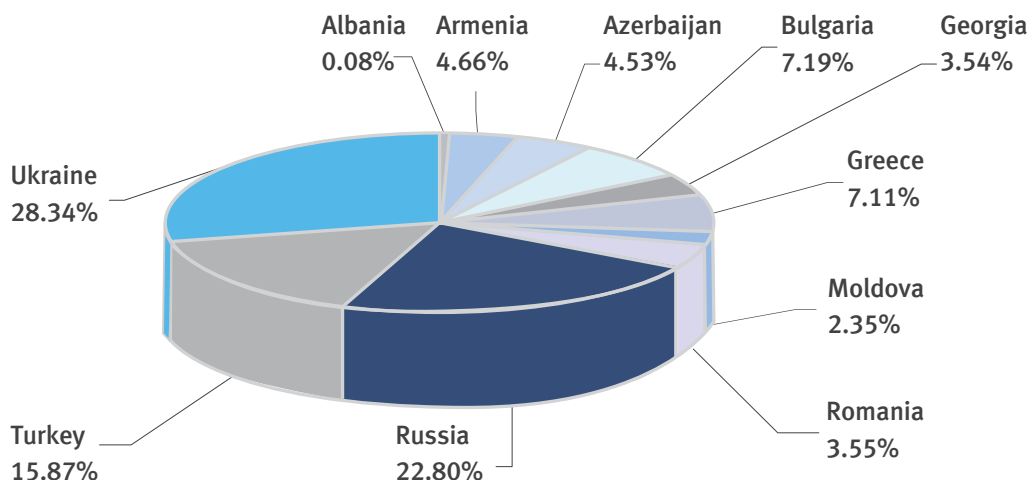
Their distribution by country is as follows:



### Outstanding Operations

As of end-2007 the outstanding operations of the Bank (cumulative disbursements less repayments for active operations) represented SDR 474 million,

distributed by country as depicted in the following graph:



### Active Portfolio Structure by Sector

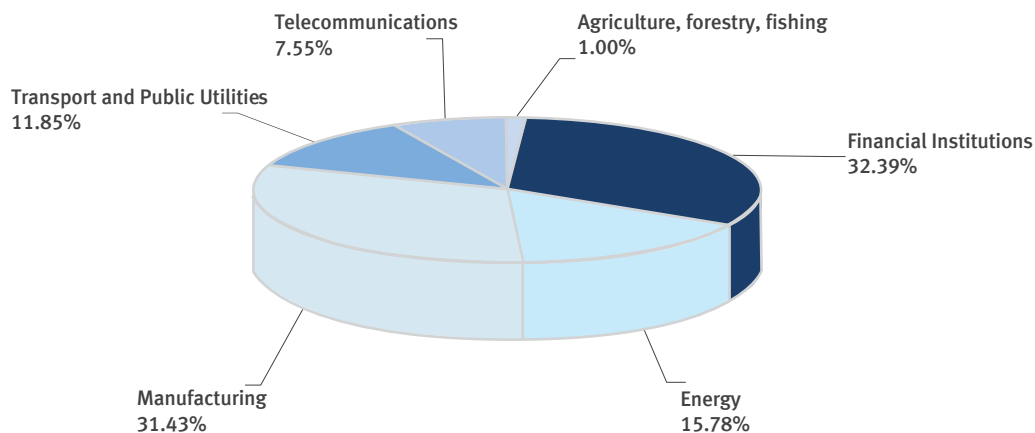
#### Approved Operations

By sector, as at end-2007 there were, approved by the Board of Directors, SDR 233.4 million in 21 operations in manufacturing, SDR 282 million in 49 operations through financial institutions, SDR 154.3 million in 10 operations in energy, SDR 101 million in 6 operations in transport and public utilities, SDR 48 million in 5 operations in telecommunications, and SDR 11 million in 2 operations in agriculture, forestry and fishing.

The portfolio structure by sector shows improved diversification relative to 2006. The number of operations in sectors with high development impact has increased. Also the outreach capacity of the Bank has been enhanced, with a larger share of the total portfolio being represented by trade finance and SME credit lines extended through financial intermediaries.

#### Signed Operations

A similar situation is seen in signed operations. The distribution of operations by sector is shown in the following graph:





# Use of Resources

RESOURCES MANAGEMENT  
FINANCIAL MANAGEMENT  
CORPORATE GOVERNANCE



## 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.

#### HR development

During 2007, the ground was prepared for the key human resources policies to be revised, with the objective of increasing the clarity, fairness and transparency of HR systems, and bringing the policies and processes in line with modern, efficient and international HR practices and standards, accentuating the investment in and development of Human Capital.

#### Staffing and recruitment

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. Twelve vacant positions were filled in 2007 (10 in executive positions and 2 in support functions). At the end of 2007, the Bank had a total of 99 employees, from 14 member and non-member countries.

#### Staff Development

The introduction of a Training Unit late in 2007 has led to an emphasis on examination and modernization of career and staff development programs, thereby supporting other HR systems for further development of the organization.

#### Staff Benefit System

The Bank operates a market-oriented staff compensation and benefits policy designed to match the employment standards of the other international financial institutions. The Bank's health and life insurance plan provides medical coverage emphasizing preventive health care and operating an advanced on-line claim tracking 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. In 2007, the Bank negotiated with the Trustee the modification of the Pension Plan rules, eliminating some discrepancies and generally upgrading the level of benefits available to departing staff members.

## Information Technologies

The Bank has improved its IT infrastructure in order to better service the growth of the BSTDB business, provide higher availability of its IT systems using advance clustering technology, and provide faster performance of its applications.

To the degree that it is possible, the Bank has standardized the technology used in order to reduce the Total Cost of Ownership of its IT infrastructure. A high degree of standardization has been implemented in the area of servers, workstations, laptops, and printers.

Security and remote access to the Bank's applications has been improved providing remote secure access to Bank users while away from the office.

## External Relations

In 2007 the Bank focused its activities on fostering institutional relations with international organizations and facilitating business generation through strengthened links with financial institutions active in the Black Sea Region. Special emphasis was placed on enhanced cooperation with the Organization of the Black Sea Economic Cooperation (BSEC) and its family institutions. The BSTDB held a joint meeting of the Board of Directors with the Committee of Senior Officials of BSEC to identify strategic directions for joint effort and synergies. Importance was attached to the BSTDB involvement in the preparation of the Black Sea Ring Highway and Motorways of the Sea projects initiated by BSEC. The Bank sponsored the Black Sea Caravan - a promotional initiative to introduce the Ring Highway project in the countries of the region. BSTDB supported the BSEC Project Development Fund by sponsoring an international promotional event in Istanbul. An access to the Bank's intranet system was made available to BSEC officials to facilitate knowledge sharing.

BSTDB cooperation with EU institutions received a strong impetus with the Communication of the European Commission on the EU Black Sea Synergy Initiative, officially launched in February 2008, which emphasizes the role of EIB, EBRD and BSTDB in co-financing and otherwise providing funding for the regional projects.

Meanwhile, the Bank has significantly intensified its contacts and information exchange with European financial institutions – members of the Association of the European Development Finance Institutions (EDFI), which resulted in the BSTDB joining the EDFI Interact Group and the application of EDFI for the Observer Status with BSTDB in early 2008. Working

contacts have been improved at different levels with KfW and DEG (Germany) under the KfW's Observer Status with BSTDB. Institutional collaboration was maintained with EIB, EBRD, NIB and other IFIs active in the region aimed at exploring co-financing opportunities.

Attaching high importance to the promotion of the principles of good governance, transparency and accountability with its clients in the region as a part of its developmental mandate, the Bank signed the Joint Corporate Governance Statement of 31 leading Development Finance Institutions acting in all regions of the world, on October 19 in Washington.

In its drive to generate business and facilitate investments in its member countries, BSTDB sponsored several regional business events, including the 1st BSEC Business Forum on SME Competitiveness and Innovation (Belgrade, March 2007) and the Municipal Infrastructure Conference (Istanbul, February 2007).

BSTDB has signed a Cooperation Agreement with the Administration of the Krasnodar region in Russia to jointly promote investment projects, following the Bank's country strategy for the Russian Federation.

The Bank hosted its Black Sea Business Day in Moldova (Chisinau, June 2007) on the occasion of the BSTDB Annual Meeting, under the auspices of the Government of the Republic of Moldova. The conference, inaugurated by the Prime Minister of Moldova, gathered the country officials, leading IFIs, and representatives of the international banking and business community to discuss investment opportunities in Moldova and the Black Sea Region at large.

## Planning and Budgeting

The planning and budgeting process is centered on the Bank's four year Medium-term Strategy and Business Plan. The Medium-term Strategy and Business Plan focuses on each major operational and financial activity in the Bank, is further detailed at country level in the respective country strategies, and is implemented through annual budgets. The budget documentation includes short-term strategies, operational targets, work programs and financial statements.

The Bank's planning process, carried out within the directives of Board of Directors approved policies and guidelines, aims to prioritise 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 for the 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 utilisation 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.

## Financial Management

### Business Volume

In this year of operation, the Bank's total assets reached SDR 565 million, representing a 43% expansion from the previous year. The Bank increased the size of its outstanding loan and equity portfolios to SDR 473,522 thousand. Funds committed but not yet disbursed stood at SDR 76,204 thousand at the end of the year.

### Revenues

Total income from lending activities rose to SDR 30,362 thousand during the year from SDR 24,003 thousand in 2006, an increase of nearly 27%. Treasury activities in 2007 generated total interest income of SDR 3,594 thousand from its available for sale and held to maturity portfolios. Operating income for the year was SDR 26,049 thousand compared to SDR 22,713 thousand in 2006, an increase of almost 15%.

### Expenses

Interest expense for the year was SDR 7,495 thousand and has significantly increased from the previous year, due to the increased borrowing requirements driven by growth in the Bank's operations portfolio. This trend is expected to continue as the Bank increases its business volume.

Administrative expenses, including depreciation, in 2007 were SDR 11,246 thousand, an increase of SDR 1,178 thousand over the previous year. Administrative expenses include salaries, benefits and other administrative costs.

Salaries and benefits, in the amount of SDR 8,876 thousand showed an increase of SDR 908 thousand from the previous year. This included a supplementary amount of SDR 357 thousand recognised in the actuarial valuation of the Bank's staff retirement plan. Other administrative costs had a modest increase from the previous year of SDR 230 thousand.

Overall, administrative expenses were well within the 2007 Budget, reflecting the Bank's effective cost controls.

### Net Income

Income before impairment during the year was SDR 14,803 thousand, higher than 2006 by SDR 2,158 thousand, which was primarily driven by the improvement in revenues. Impairment losses were substantially increased from the previous year due to an increase in general provisions, consistent with higher business volumes.

The Bank posted a net income for the year of SDR

9,097 thousand, while the quality of the portfolio remained high with no new impaired operations.

### 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 (eight equal 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 2007, over SDR 290.5 million out of SDR 291 million due on the date were 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 eight annual instalments of the twenty per cent shares payable by promissory notes. The total initial authorised capital stock of the Bank of SDR one billion remained unchanged.

On December 2, 2007 the BSTDB Board of Governors decided to increase the authorised capital of the Bank from SDR 1 billion to SDR 3 billion (approx. USD 4,8 billion). The Board of Governors additionally authorised the offering of SDR 1 billion for subscription by the existing 11 Member - States, thus increasing the subscribed capital to SDR 2 billion. The paid-in portion of the newly subscribed capital will be 30%, with 70% callable - in line with the current capital structure.

### Gearing Ratio

The Establishing Agreement places a number of institutional limitations on the use of the Bank's capital for its ordinary operations. Treasury invest-

ments, 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 2007 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 2007 stood at SDR 25,846 thousand, equivalent to 5.6% of the outstanding loan portfolio.

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

### Reserves and Surplus

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

In addition to building up a cushion of reserves, the Bank also set aside retained income to enable it to maintain the real value of its capital funds and increase its invest-

ment headroom through internally generated funds.

### Market Risks

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

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.

### Operational Risks

The Bank, like all financial institutions, is exposed to operational risks, which are other than those risks falling within the scope of credit and market risk. The Bank relies upon internal controls within offices and departments for its operational risk management, which evolves best practice and methods to be dedicated for managing and coordinating operational risks.

Appropriate measures are taken into consideration towards achieving a high level of operational risk awareness and the enhancement of the operational risk management system. The Bank has established disaster recovery and business continuity plans that take into account different types of plausible scenarios to which the Bank may be vulnerable. Additionally, operational risk is managed through the purchase of insurance policies to confront potential losses which may occur as a result of various events and natural disasters.

Furthermore, the Bank utilises the Basic Indicator Approach (BIA) as issued by the Basel Committee to quantify operational risk incurred. Banks using the BIA must hold capital for operational risk equal to the average over the previous three years of a fixed percentage of positive annual gross income. Figures for any year in which annual gross income is negative or zero should be excluded from

both the numerator and denominator when calculating the average. Should the Bank quantify the operational risk incurred in its operations it would, with the use of the BIA, amount to less than SDR 4 thousand for the year 2007, being a fraction of the Bank's total reserves amount.

### **Investment / Liquidity**

The Bank's surplus funds totalling SDR 105,768 thousand as at 31 December 2007 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 & Poors credit rating agency.
- Euro commercial paper rated at a minimum short term A2/P2 by either Moody's or Standard & Poors 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 245% on 31 December 2007.

### **Borrowing**

At end of 2007, the Bank had signed loan agreements for EUR 15 million and USD 350 million. As the size of the Bank's operation portfolios continue to increase, and taking into consideration its minimum liquidity requirements, the Bank will access sources of long term funds in 2008.

The Bank has a long term investment grade rating of Baa1, from Moody's Investor Services which in 2007 was moved from a stable to a positive outlook. The Banks short term rating has remained stable at P2.

### **Risk Analysis**

An independent financial analysis is performed for each of the Bank's operations. Corporate entities are initially subject to an assessment of creditworthiness based on historical financial statements. This is followed by cashflow modelling 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. capitalisation, 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 borrower where the borrower's inability or anticipated inability to service its debt is due to a general foreign exchange shortage in the borrower's country.

## Corporate Governance

### Management Structure

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

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

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

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

The Management Committee comprises 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 Secretary. The Annual Report for 2007 is the ninth 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 (primarily through its Audit Committee). The Audit Committee has the responsibility, inter alia, of satisfying itself that the internal audit process is adequate and efficient through reviewing the policy, 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 main 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 mission is to foster and 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 performances and independence of the External Auditors are assessed by the Audit Committee.



# Financial Statements and Notes

FINANCIAL STATEMENTS  
FOR THE YEAR ENDED  
31 DECEMBER 2007



## INCOME STATEMENT

For the year ended 31 December 2007

Expressed in thousands of SDR	Note	2007	2006
Interest and similar income	6	31,450	25,267
Interest and similar expense	7	(7,495)	(4,082)
<b>Net interest income</b>		<b>23,955</b>	<b>21,185</b>
Fees and commission income	8	2,506	1,757
Fees and commission expense	9	(478)	(260)
Net gains from available-for-sale treasury assets		1	0
Net income (loss) on foreign exchange		102	79
Other income (expense)	10	(37)	(48)
<b>Operating income</b>		<b>26,049</b>	<b>22,713</b>
Administrative expenses	11	10,972	9,834
Depreciation and amortisation	19,20	274	234
<b>Income before impairment</b>		<b>14,803</b>	<b>12,645</b>
Impairment losses on loans	12	5,706	1,175
<b>Net income for the year</b>		<b>9,097</b>	<b>11,470</b>

The accompanying notes are an integral part of this statement.

## BALANCE SHEET

At 31 December 2007

Expressed in thousands of SDR	Note	2007	2006
<b>Assets</b>			
Cash and bank balances	24,25	5,320	993
Placements with financial institutions	24,25	0	4,985
Investment securities:			
Available-for-sale	25	44,562	27,491
Held-to-maturity	24,25	55,886	76,053
Total deposits and investments		105,768	109,522
Derivative financial instruments	14	238	0
Loans	15,17	465,632	295,072
Less: impairment losses on loans	12	(25,846)	(21,017)
Loans net of impairment		439,786	274,055
Equity investments:			
Available-for-sale	16,17	7,890	4,852
Other assets	18	10,381	6,502
Property and equipment	19	308	203
Intangible assets	20	449	587
<b>Total Assets</b>		<b>564,820</b>	<b>395,721</b>
<b>Liabilities</b>			
Borrowings	21	231,795	73,506
Derivative financial instruments	14	0	26
Payables and accrued interest	22	2,159	1,754
Deferred income	8	3,200	2,295
Total liabilities		237,154	77,581
<b>Members' Equity</b>			
Authorised share capital	13	1,000,000	1,000,000
Less: unallocated share capital	13	(30,000)	(30,000)
Subscribed share capital	13	970,000	970,000
Less: callable share capital	13	(679,000)	(679,000)
Advance against future call	13	35	37
Paid-in share capital		291,035	291,037
Reserves	23	18,544	13,493
Retained earnings		18,087	13,610
Total members' equity		327,666	318,140
<b>Total Liabilities and Members' Equity</b>		<b>564,820</b>	<b>395,721</b>
<b>Off-balance-sheet items</b>			
Commitments	17	76,204	75,075

The accompanying notes are an integral part of this statement.

## STATEMENT OF CHANGES IN MEMBERS' EQUITY

For the year ended 31 December 2007

Expressed in thousands SDR	Share capital			Reserves	Retained Earnings	Total
	Subscribed	Callable	Payable			
<b>At 31 December 2005</b>	<b>970,000</b>	<b>(679,000)</b>	<b>35</b>	<b>5,682</b>	<b>10,391</b>	<b>307,108</b>
Net gain of available-for-sale (note 23)				(440)		(440)
Income recognised directly in equity				(440)		(440)
Net income for the year					11,470	11,470
Total income for the year				(440)	11,470	11,030
Advance against future call			2			2
General reserve				8,251	(8,251)	0
<b>At 31 December 2006</b>	<b>970,000</b>	<b>(679,000)</b>	<b>37</b>	<b>13,493</b>	<b>13,610</b>	<b>318,140</b>
Net gain of available-for-sale (note 23)				431		431
Income recognised directly in equity				431		431
Net income for the year					9,097	9,097
Total income for the year				431	9,097	9,528
Advance against future call			(2)			(2)
General reserve				4,620	(4,620)	0
<b>At 31 December 2007</b>	<b>970,000</b>	<b>(679,000)</b>	<b>35</b>	<b>18,544</b>	<b>18,087</b>	<b>327,666</b>

The accompanying notes are an integral part of this statement.

## STATEMENT OF CASH FLOWS

For the year ended 31 December 2007

Expressed in thousands of SDR	Note	2007	2006
<b>Cash flows from operating activities</b>			
Net income for the year		9,097	11,470
Adjustment for:			
Impairment losses on loans	12	5,706	1,175
Depreciation and amortisation	19,20	274	234
Interest and similar income		(31,450)	(25,267)
Interest and similar expense		7,495	4,082
Foreign exchange adjustments on provisions	12	(877)	(706)
Operating income before changes in operating assets		(9,755)	(9,012)
Derivative movements	14	(264)	521
Decrease (increase) in other assets	18	(519)	66
Increase (decrease) in accounts payable	22	(379)	693
Increase (decrease) in deferred income	8	905	145
Interest and similar income received		27,686	23,609
Interest and similar expense paid	22	(6,711)	(3,734)
Fair value movements		431	188
Cash generated from operations		11,394	12,476
Proceeds from repayment of loans	15	215,115	148,483
Proceeds from repayment of equity investments		3,457	349
Funds advanced for loans	15	(385,675)	(169,818)
Funds advanced for equity investments		(6,492)	(1,911)
Net cash used in operating activities		(162,201)	(10,421)
<b>Cash flows from investing activities</b>			
Proceeds from available-for-sale investment securities		6,759	0
Purchase of available-for-sale investment securities		(23,831)	(27,491)
Purchase of property, technology and equipment	19,20	(242)	(397)
Net cash used in investing activities		(17,314)	(27,888)
<b>Cash flows from financing activities</b>			
Decrease in share capital short-term receivable	13	404	1,880
Increase (decrease) in advance against future call	13	(2)	2
Paid-in share capital received		402	1,882
Proceeds from borrowings	21	314,273	101,483
Repayments of borrowings	21	(155,985)	(70,834)
Net cash provided by financing activities		158,690	32,531
<b>Net increase (decrease) in cash and cash equivalents</b>		<b>(20,825)</b>	<b>(5,778)</b>
Cash and cash equivalents at beginning of year		82,031	87,809
<b>Cash and cash equivalents at end of year</b>	24	<b>61,206</b>	<b>82,031</b>

The accompanying notes are an integral part of this statement.

# NOTES TO THE FINANCIAL STATEMENTS

For the year ended 31 December 2007

## 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 Komnion 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 businesses in the whole region as well as for those active only in its individual Member Countries. The Bank offers project and trade financing facilities, equity participations and guarantees. Bank financing of projects and programs is available directly or in cooperation with other national and international development institutions. The Bank may also, where appropriate, provide technical assistance to potential clients.

As at 31 December 2007 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 (the “Headquarters Agreement”) signed on 22 October 1998.

### 1.3 Approval of Financial Statements

The financial statements for 2007 were submitted by the Management Committee to the Board of Directors for approval on 4 April 2008. 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 8 June 2008.

## 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 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 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 date of transaction. 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 are as follows:

	31 December 2007	31 December 2006
1 SDR = United States dollar	1.57848	1.50440
Euro	1.07350	1.14151
Japanese yen	178.14720	178.81321
Pound sterling	0.78932	0.76638
Romanian lei	3.86380	-

## 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 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 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 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.

#### 2.3.1b 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. Placements with financial institutions are also included in this category. 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.

#### 2.3.1c derivative financial instruments

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

### 2.3.2 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.

#### 2.3.2a impairment for loan losses

For amounts due from loan and receivable portfolios including losses under guarantees and commitments, the Bank first assesses on an individual basis whether objective evidence of impairment exists individually for those that are individually significant, or collectively for those that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed loan asset, whether significant or not, it includes the asset in a group of assets with similar credit risk characteristics and collectively assesses them for impairment. Loan assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss has been incurred, that the Bank will not be able to collect all amounts due (principal and interest) according to original contractual terms 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 (excluding future credit losses that have not yet been incurred). The carrying amount of such an asset is reduced to its estimated recoverable amount through use of an allowance for impairment account and the amount of loss is recognised in the income statement. Interest income continues to be accrued based on the original effective interest rate of the

asset. 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.

A loan asset together with the associated allowance are written off when all or part of it 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. Whenever an amount of the estimated impairment loss increases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased by adjusting the allowance account. Recoveries of loans written off in earlier periods are included in the income statement.

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

For the purpose of a collective evaluation of impairment, loan assets are grouped on the basis of the Bank's internal credit grading methodology that considers credit risk characteristics such as asset type, industry and geographical location. The Bank's collective evaluation of impairment is based on the banking systems in the BSEC countries, as approved by the Credit Committee. The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any difference between loss estimates and actual loss experience. On the portfolio basis, management estimates that the 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.

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

### 2.3.3 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 Non Financial Assets

At the balance sheet date, the Bank's management reviews the value of the non financial assets and assesses whether there is any indication of impairment. If such indications exist an analysis is performed to assess whether the book value of the specific assets can be recovered. The recoverable amount is the higher amount between the net value of sale (value of sale reduced by sale expenses) and of the 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.

As an alternative local staff are entitled to retirement benefits from the Greek State Social Insurance Fund (IKA).

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

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

## 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 using the effective interest rate method.

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

#### **2.15 Operating Leases**

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

#### **2.16 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 original maturities of three months or less.

#### **2.17 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 and the staff retirement plan as referred in these notes. Such differences are believed not material and do not affect these financial statements.

#### **2.18 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**

Risk is inherent in the Bank's activities but it is managed through a process of ongoing identification, measurement and monitoring that is subject to risk limits and controls. The process of risk management is critical to the Bank's continuing operations and profitability. The Board of Directors has approved risk management policies and guidelines that delegate to the Management Committee and related departments of the Bank in identifying and controlling risk.

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

#### **3.1 Financial Risk**

The Bank exposure to financial risk is through its financial assets and liabilities including the receivables from these financial assets. The key aspects of financial risk are (i) credit risk and (ii) liquidity 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. The Bank's lending activities are the main source of credit risk since the lenders 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 liquidity securities. For this, the Bank estimates and relates all expected cash flows from assets and liabilities.

### 3.2 Market Risk

Market risk refers to the probability of losses due to changes or fluctuations in the market prices of financial instruments, interest rates and exchange rates. The Bank uses modern methods for measuring market risk and 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. The key aspects of market risk are (i) foreign exchange risk and (ii) interest rate risk.

#### 3.2.1 Foreign Exchange Risk

The Bank monitors its assets and liabilities in the SDR basket currencies in order to ensure it takes no significant foreign exchange risks.

#### 3.2.2 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.

### 3.3 Operational Risk

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

### 3.4 Collateral and Credit Enhancements

#### 3.4.1 Loans and Advancements

The Bank's security under banking operation guidelines set the amount and type of collateral and other credit enhancements.

The main types of collateral that may be obtained by the Bank are mortgages on properties and equipment, pledges of equity shares and investment instruments, assignment of rights on certain contracts, cash or blocked deposits and other third party guarantees. When needed the Bank reassesses the change in the market value of collateral and, if necessary, request the pledging of additional collateral in accordance with the relevant agreement.

#### 3.4.2 Other Financial Instruments

Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Investment securities, treasury bills and other eligible bills are generally unsecured with the exception of asset-backed securities and similar instruments, which may be secured by pools of financial assets.

## 4. NEW ACCOUNTING STANDARDS AND INTERPRETATIONS OF IASB

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for accounting periods on or after 1 January 2007 or later periods but which the Bank has not early adopted, as follows:

**IFRS 2:** Amendments to IFRS 2 Share Based Payment – Vesting Conditions and Cancellations (effective for financial years beginning on or after 1 January 2009).

The amendment clarifies two issues: the definition of “vesting condition”, introducing the term “non-vesting condition” for conditions other than service conditions and performance conditions. It also clarifies that the same accounting treatment applies to awards that are effectively cancelled by either the entity or the counterparty. The Bank expects that this Interpretation will have no impact on its financial statements.

**IFRS 3:** Revisions to IFRS 3 Business Combinations and IAS 27 Consolidated and Separate Financial Statements (effective for financial years beginning on or after 1 July 2009).

A revised version of IFRS 3 Business Combinations and an amended version of IAS 27 Consolidated and Sepa-

rate Financial Statements will be issued by IASB on 10 January 2008. IFRS 3R introduces a number of changes in the accounting for business combinations which will impact the amount of goodwill recognized, the reported results in the period that an acquisition occurs, and future reported results. Such changes include the expensing of acquisition-related costs and recognizing subsequent changes in fair value of contingent consideration in the profit or loss (rather than by adjusting goodwill). IAS 27R requires that a change in ownership interest of a subsidiary is accounted for as an equity transaction. Therefore such a change will have no impact on goodwill, nor will it give rise to a gain or loss. Furthermore the amended standard changes the accounting for losses incurred by the subsidiary as well as the loss of control of a subsidiary. The changes introduced by IFRS 3R and IAS 27R must be applied prospectively and will affect future acquisitions and transactions with minority interests. The Bank shall apply IFRS 3 where relevant.

**IFRS 8:** Operating Segments (effective for financial years beginning on or after 1 January 2009).

IFRS 8 replaces IAS 14 Segment Reporting and adopts a management approach to segment reporting. The information reported would be that which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. This information may be different from that reported in the balance sheet and income statement and entities will need to provide explanations and reconciliations of the differences. The Bank is in the process of assessing the impact this new standard will have on its financial statements.

**IAS 1:** Amendments to IAS 1 Presentation of Financial Statements (effective for financial years beginning on or after 1 January 2009).

IAS 1 has been revised to enhance the usefulness of information presented in the financial statements. Of the main revisions are the requirement that the statement of changes in equity includes only transactions with shareholders the introduction of a new statement of comprehensive income that combines all items of income and expense recognised in profit or loss together with “other comprehensive income” and the requirement to present restatements of financial statements or retrospective application of a new accounting policy as at the beginning of the earliest comparative period, ie: a third column on the balance sheet. The Bank will make the necessary changes to the presentation of its financial statements in 2009.

**IAS 23:** Amendment to IAS 23 Borrowing Costs (effective for financial years beginning on or after 1 January 2009).

The benchmark treatment in the existing standard of expensing all borrowing costs to the income statement is eliminated in the case of qualifying assets. All borrowing costs that are directly attributable to the acquisition or construction of a qualifying asset must be capitalised. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. In accordance with the transitional requirements of the Standard, the Bank will adopt this as a prospective change. Accordingly, borrowing costs will be capitalised on qualifying assets with a commencement date after 1 January 2009. No changes will be made for borrowing costs incurred to this date that have been expensed.

**IAS 32:** Amendments to IAS 32 and IAS 1 Puttable Financial Instruments (effective for financial years beginning on or after 1 January 2009).

The amendment to IAS 32 requires certain puttable financial instruments and obligations arising on liquidation to be classified as equity if certain criteria are met. The amendment to IAS 1 requires disclosure of certain information relating to puttable instruments classified as equity. The Bank does not expect these amendments to impact its financial statements.

**IFRIC Interpretation 11:** IFRS 2 – Group and Treasury Share Transactions (effective for financial years beginning on or after 1 March 2007).

This Interpretation requires arrangements whereby an employee is granted rights to an entity’s equity instruments to be accounted for as an equity-settled scheme by an entity even if the entity chooses or is required to buy those equity instruments from another party, or the shareholders of the entity provide the equity instruments needed. The Interpretation also extends to the way in which subsidiaries, in their separate financial statements, account for schemes when their employees receive rights to equity instruments of the parent. IFRIC 11 is not relevant to the Bank’s operations.

**IFRIC Interpretation 12:** Service Concession Arrangements (effective for financial years beginning on or after 1 January 2008).

IFRIC 12 outlines an approach to account for contractual (service concession) arrangements arising from entities providing public services. It provides that the operator should not account for the infrastructure as property, plant and equipment, but recognise a financial asset and / or an intangible asset. IFRIC 12 is not relevant to the Bank’s operations.

**IFRIC Interpretation 13:** Customer Loyalty Programmes (effective for financial years beginning on or after 1 July 2008).

IFRIC 13 requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled. IFRIC 13 is not relevant to the Bank's operations.

**IFRIC Interpretation 14:** IAS 19 – the Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction (effective for financial years beginning on or after 1 January 2008).

IFRIC 14 provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognised as an asset under IAS 19 Employee Benefits. It also explains how this limit, also referred to as the "asset ceiling test", may be influenced by a minimum funding requirement and aims to standardize current practice. The Bank expects that this Interpretation will have no impact on its financial position or performance as none of the defined benefit schemes are currently in deficit.

## 5. SEGMENT REPORTING

The Bank is a multilateral finance institution dedicated to accelerate development and promote cooperation among its shareholder countries. The Bank's products and services are similar and are structured and distributed in a fairly uniform manner, as such the Bank operates in a single geographical segment. The primary reporting format for business segments is as follows:

Expressed in SDR (000)	2007			2006		
	Banking	Treasury	Total	Banking	Treasury	Total
<b>Income statement</b>						
Interest income	27,856	3,594	31,450	22,246	3,021	25,267
Fees and commission income	2,504	2	2,506	1,755	2	1,757
Total segment revenues	30,360	3,596	33,956	24,001	3,023	27,024
Less: interest expense	(7,356)	(139)	(7,495)	(3,535)	(547)	(4,082)
Less: fees and commission expense	(478)	-	(478)	(260)	-	(260)
Net fair value, foreign exchange and other	(37)	103	66	(31)	62	31
Less: administrative expenses	(10,462)	(510)	(10,972)	(9,422)	(412)	(9,834)
Less: depreciation and amortisation	(203)	(71)	(274)	(221)	(13)	(234)
Segment income before impairment	11,824	2,979	14,803	10,532	2,113	12,645
Impairment losses on loans	(5,706)	-	(5,706)	(1,175)	-	(1,175)
<b>Net income for the year</b>	<b>6,118</b>	<b>2,979</b>	<b>9,097</b>	<b>9,357</b>	<b>2,113</b>	<b>11,470</b>
<b>Balance sheet</b>						
Segment assets	459,052	105,768	564,820	286,199	109,522	395,721
Segment liabilities	236,407	747	237,154	77,579	2	77,581
Members' equity	-	-	327,666	-	-	318,140
<b>At 31 December</b>			<b>564,820</b>			<b>395,721</b>

## 6. INTEREST AND SIMILAR INCOME

Interest and similar income is analysed as follows:

	Year to 31 December 2007	Year to 31 December 2006
Expressed in SDR (000)		
From loans	27,856	22,246
From placements with financial institutions	945	697
From investment securities: available-for-sale	2,027	968
From investment securities: held-to-maturity	506	1,356
From financial assets at fair value	116	-
<b>Interest and similar income</b>	<b>31,450</b>	<b>25,267</b>

## 7. INTEREST AND SIMILAR EXPENSE

Interest and similar expense is analysed as follows:

	Year to 31 December 2007	Year to 31 December 2006
Expressed in SDR (000)		
From borrowed funds	6,506	3,486
From financial liabilities at fair value	794	444
Other charges	195	152
<b>Interest and similar expense</b>	<b>7,495</b>	<b>4,082</b>

## 8. FEES AND COMMISSION INCOME

Fees and commission income is analysed as follows:

	Year to 31 December 2007	Year to 31 December 2006
Expressed in SDR (000)		
Front-end fees	1,284	1,009
Commitment fees	265	288
Management fees	151	57
Appraisal fees	57	72
Prepayment/cancellation fees	277	71
Other	472	260
<b>Fees and commission income</b>	<b>2,506</b>	<b>1,757</b>

## 9. FEES AND COMMISSION EXPENSE

Fees and commission expense is analysed as follows:

	Year to 31 December 2007	Year to 31 December 2006
Expressed in SDR (000)		
Appraisal fees	6	-
Out of pocket recoverables	472	260
<b>Fees and commission expense</b>	<b>478</b>	<b>260</b>

## 10. OTHER INCOME (EXPENSE)

Other income and expense are primarily legal fees, consulting fees not relating to the current operations of the Bank.

## 11. ADMINISTRATIVE EXPENSES

Administrative expenses in the income statement are analysed as follows:

Expressed in SDR (000)	Year to 31 December 2007	Year to 31 December 2006
Salaries and benefits	7,553	6,443
Staff retirement plan (note 29)	1,323	1,525
Other administrative expenses	2,824	2,516
Total	11,700	10,484
Host country reimbursement	(728)	(650)
<b>Administrative expenses</b>	<b>10,972</b>	<b>9,834</b>

The average number of staff employed during the year was 99 (2006: 97). The number of staff at 31 December 2007 was 99 (2006: 99)

## 12. IMPAIRMENT LOSSES ON LOANS

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

Expressed in SDR (000)	Collective	Specific	Total
At 31 December 2005	14,391	6,157	20,548
Charge for the year	322	853	1,175
Foreign exchange adjustments	(392)	(314)	(706)
At 31 January 2006	14,321	6,696	21,017
Charge for the year	5,109	604	5,713
Against amounts written off	(7)	-	(7)
Foreign exchange adjustments	(539)	(338)	(877)
<b>At 31 December 2007</b>	<b>18,884</b>	<b>6,962</b>	<b>25,846</b>

At 31 December 2007 the Bank categorised one loan as impaired. The total exposure amounts to SDR 6,962 thousand and the provision on this asset amounted to SDR 6,962 thousand.

## 13. 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 is analysed as follows:

	At 31 December 2007	At 31 December 2006
Expressed in SDR (000)		
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)
Called-up share capital	291,000	291,000
Advance against future call	35	37
<b>Paid-in share capital</b>	<b>291,035</b>	<b>291,037</b>

\* 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 of the year one Member State 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 2007 was SDR 456 thousand and at 31 December 2006 was SDR 860 thousand. The capital subscription status, which has no change since 31 December 2004, and voting power based on the paid amount, of each member at 31 December 2007 is analysed as follows:

Member	Shares	Subscribed	Callable	Payable	Paid	Voting Power
		Expressed in SDR (000)				
Albania	20,000	20,000	14,000	6,000	6,000	2.1%
Armenia	10,000	10,000	7,000	3,000	3,000	1.0%
Azerbaijan	20,000	20,000	14,000	6,000	6,000	2.1%
Bulgaria	135,000	135,000	94,500	40,500	40,500	14.0%
Georgia	10,000	10,000	7,000	3,000	2,544	0.8%
Greece	165,000	165,000	115,500	49,500	49,500	17.0%
Moldova	10,000	10,000	7,000	3,000	3,000	1.0%
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	17.0%
Turkey	165,000	165,000	115,500	49,500	49,500	17.0%
Ukraine	135,000	135,000	94,500	40,500	40,500	14.0%
<b>Total</b>	<b>970,000</b>	<b>970,000</b>	<b>679,000</b>	<b>291,000</b>	<b>290,544</b>	<b>100.0%</b>

## 14. 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 end of year that are neither indicative of the market risk nor credit risk.

Forward foreign exchange contracts are valued by using spot exchange rates at the balance sheet date, and forward foreign exchange points are accrued on a daily basis.

	At 31 December 2007		At 31 December 2006	
	Notional Amount	Fair Value	Notional amount	Fair value
Expressed in SDR (000)				
Currency swap purchases	35,684	35,627	7,530	7,528
Currency swap sales	35,761	35,865	7,508	7,502
<b>Derivative financial instruments</b>	<b>77</b>	<b>238</b>	<b>(22)</b>	<b>(26)</b>

## 15. LOANS

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

	At 31 December 2007	At 31 December 2006
Expressed in SDR (000)		
At 1 January	295,072	273,736
Disbursements	373,181	154,173
Less: repayments	(194,402)	(128,988)
Foreign exchange movements	(8,098)	(3,849)
Written off	(121)	-
At end of year	465,632	295,072
Less: impairment losses on loans (note 12)	(25,846)	(21,017)
<b>Loans net of impairment</b>	<b>439,786</b>	<b>274,055</b>

Interest is generally based on Libor for USD loans and Euribor for EUR loans plus a margin. Margins are dependent on the risk category of each loan and typically range from 1.5% to 4.0%. As of 31 December 2007 there is one impaired loan for which interest is not being accrued.

The fair value of the loan portfolio is approximately equal to book value plus amortised cost as all loans bear a variable interest rate and are given at market terms and conditions. Renegotiated loans that would otherwise be past due or impaired at 31 December 2006 were an amount of SDR 9,636 thousand. As of 31 December 2007 there were no loans renegotiated or past due. Further analysis of the loan portfolio is presented in note 17.

## 16. EQUITY INVESTMENTS

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

	% of investment	Total net Equity	At 31 December 2007		At 31 December 2006	
			Carrying Amount	Fair Value	Carrying Amount	Fair Value
Expressed in SDR (000)						
SEAF Trans-Balkan Fund LLC	18.33	6,730	1,234	1,104	1,354	1,996
Micro Finance Bank of Azerbaijan	25.55	5,067	1,295	1,462	1,148	1,163
Transgaz Romania	0.87	142,360	1,239	1,571	-	-
Balkan Accession Fund	9.09	19,541	1,776	1,852	1,696	1,693
Placement shares - Teleset Networks	7.84	24,233	1,900	1,901	-	-
<b>Available-for-sale</b>			<b>7,444</b>	<b>7,890</b>	<b>4,198</b>	<b>4,852</b>



The valuation of such investments, which are unlisted, has been based on their latest audited accounts as of the 31 December 2006, with the exception of the Balkan Accession Fund which were received unaudited and are last audited as of 31 December 2005. As at 31 December 2007 the Teleset Networks investment was accounted as placement shares.

An increase of SDR 1,725 thousand since the acquisition of the investments was due to an unrealized gain in fair value, attributable to the Bank's participation. At 31 December 2007 the Bank has not engaged in any equity investments that are held for trading and has not realized any gains or losses during the year.

The Bank has a committed amount of SDR 6,391 thousand towards the above entities share capital, which as of 31 December 2007 has not been called-up.

## 17. OPERATIONAL ANALYSIS

The analysis of operational activity of the Bank, which is also its maximum exposure to credit risk, by geographical area, instrument and sector are presented as below:

Expressed in SDR (000)	At 31 December 2007		At 31 December 2006	
	Outstanding disbursements	Undrawn commitments	Outstanding disbursements	Undrawn commitments
Analysis by instrument				
Loans	465,632	69,813	295,072	67,538
Equity investments	7,890	6,391	4,852	7,537
<b>At end of year</b>	<b>473,522</b>	<b>76,204</b>	<b>299,924</b>	<b>75,075</b>

### Analysis by country

Armenia	21,967	1,156	18,274	2,454
Azerbaijan	21,371	6,071	18,948	1,943
Bulgaria	33,506	5,618	14,482	12,810
Georgia	16,705	1,901	15,057	5,451
Greece	33,535	-	39,032	-
Moldova	10,695	2,795	2,462	2,161
Romania	17,025	-	18,024	4,380
Russia	107,547	12,037	35,640	13,294
Turkey	74,887	19,773	64,311	25,416
Ukraine	133,328	20,462	70,005	-
Regional	2,956	6,391	3,689	7,166
<b>At end of year</b>	<b>473,522</b>	<b>76,204</b>	<b>299,924</b>	<b>75,075</b>

### Analysis by sector

Financial institutions	151,752	17,132	88,093	24,619
General industries*	216,628	33,226	117,280	39,202
Energy & infrastructure	105,142	25,846	94,551	11,254
<b>At end of year</b>	<b>473,522</b>	<b>76,204</b>	<b>299,924</b>	<b>75,075</b>

\* Also includes transport and tourism.

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

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

## 18. OTHER ASSETS

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

Expressed in SDR (000)	At 31 December 2007	At 31 December 2006
Accrued interest	8,625	4,861
Paid-in share capital not received	456	860
Advances and prepaid expenses	649	234
Pending pension plan	209	130
Rental reimbursement receivable*	375	334
Guarantee deposits	67	83
<b>Other assets</b>	<b>10,381</b>	<b>6,502</b>

\* The Hellenic Republic will grant the rental already being reimbursed.

## 19. 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
<b>Cost</b>					
At 31 December 2005	146	32	348	1,076	1,602
Additions	5	-	6	81	92
At 31 December 2006	151	32	354	1,157	1,694
Additions	11	58	28	116	213
Disposals	-	(32)	-	-	(32)
<b>At 31 December 2007</b>	<b>162</b>	<b>58</b>	<b>382</b>	<b>1,273</b>	<b>1,875</b>
<b>Accumulated depreciation</b>					
At 31 December 2005	131	32	331	869	1,363
Charges for the year	6	-	12	110	128
At 31 December 2006	137	32	343	979	1,491
Charges for the year	9	7	6	86	108
Disposals	-	(32)	-	-	(32)
<b>At 31 December 2007</b>	<b>146</b>	<b>7</b>	<b>349</b>	<b>1,065</b>	<b>1,567</b>
<b>Net book value</b>					
<b>At 31 December 2007</b>	<b>16</b>	<b>51</b>	<b>33</b>	<b>208</b>	<b>308</b>
At 31 December 2006	14	0	11	178	203
At 31 December 2005	15	0	17	207	239

## 20. INTANGIBLE ASSETS

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

Expressed in SDR (000)	Total
Cost	
At 31 December 2005	1,230
Additions	305
At 31 December 2006	1,535
Additions	29
<b>At 31 December 2007</b>	<b>1,564</b>
Accumulated amortisation	
At 31 December 2005	842
Charges for the year	106
At 31 December 2006	948
Charges for the year	167
<b>At 31 December 2007</b>	<b>1,115</b>
Net book value	
<b>At 31 December 2007</b>	<b>449</b>
At 31 December 2006	587
At 31 December 2005	388

\* Intangible assets comprises of computer software.

## 21. BORROWINGS

Borrowing facilities arranged at end of the year were SDR 236,453 thousand of which an amount of SDR 4,658 thousand 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.

Expressed in SDR (000)	At 31 December 2007		At 31 December 2006	
	Amount used	Borrowings arranged	Amount used	Borrowings arranged
Euro	10,062	14,720	-	13,140
United States dollar	221,733	221,733	73,121	73,121
Other	-	-	385	385
<b>Total</b>	<b>231,795</b>	<b>236,453</b>	<b>73,506</b>	<b>86,646</b>

The Interest rate on borrowings falls within a range of USD Libor to USD Libor+50 points. There is no collateral against the above borrowed funds. The fair value of the borrowings is approximately equal to carrying value.

## 22. PAYABLES AND ACCRUED INTEREST

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

Expressed in SDR (000)	At 31 December 2007	At 31 December 2006
Interest	1,214	430
Social insurance fund (IKA) contributions	23	22
Pension plan obligation (note 29)	697	691
Suppliers and other accrued expenses	225	611
<b>Payables and accrued interest</b>	<b>2,159</b>	<b>1,754</b>

## 23. RESERVES

Reserves in the accompanying balance sheet are analysed as follows:

	At 31 December 2007	At 31 December 2006
Expressed in SDR (000)		
General	16,686	12,066
Available-for-sale revaluation	1,858	1,427
<b>Reserves</b>	<b>18,544</b>	<b>13,493</b>

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, the revaluation reserve has been adjusted relating to the increase in unrealized profit of SDR 431 thousand on available-for-sale investments.

## 24. 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:

	At 31 December 2007	At 31 December 2006
Expressed in SDR (000)		
Cash	1	1
Bank balances/placements and/or investments:		
Up to 1 month	61,205	82,030
<b>Cash and cash equivalents</b>	<b>61,206</b>	<b>82,031</b>

The commercial paper held in the Bank's portfolio is rated at a minimum of A2 by Standard and Poors or P2 by Moody's, in accordance with internal financial policies.

## 25. ANALYSIS BY RATING AGENCY

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

Expressed in SDR (000)	2007			Total
	Aaa – Aa3	A1 – Baa3	Unrated	
Analysis by Moody's rating				
Cash and bank balances	5,320	-	-	5,320
Placements with financial institutions	-	-	-	0
Investment securities	27,907	72,541	-	100,448
Equity investments	-	-	7,890	7,890
<b>At 31 December</b>	<b>33,227</b>	<b>72,541</b>	<b>7,890</b>	<b>113,658</b>
Of which issued by				
Governments	-	16,655	-	16,655
Corporates	27,907	55,886	7,890	91,683
Deposits at banks	5,320	-	-	5,320
<b>At 31 December</b>	<b>33,227</b>	<b>72,541</b>	<b>7,890</b>	<b>113,658</b>
Of which classified as				
Available-for-sale	27,907	16,655	7,890	52,452
Held-to-maturity	5,320	55,886	-	61,206
<b>At 31 December</b>	<b>33,227</b>	<b>72,541</b>	<b>7,890</b>	<b>113,658</b>

Expressed in SDR (000)	2006			Total
	Aaa – Aa3	A1 – Baa3	Unrated	
Analysis by Moody's rating				
Cash and bank balances	993	-	-	993
Placements with financial institutions	4,985	-	-	4,985
Investment securities	51,351	52,193	-	103,544
Equity investments	-	-	4,852	4,852
<b>At 31 December</b>	<b>57,329</b>	<b>52,193</b>	<b>4,852</b>	<b>114,374</b>
Of which issued by				
Governments	-	-	-	0
Corporates	51,351	52,193	4,852	108,396
Deposits at banks	5,978	-	-	5,978
<b>At 31 December</b>	<b>57,329</b>	<b>52,193</b>	<b>4,852</b>	<b>114,374</b>
Of which classified as				
Available-for-sale	27,491	-	4,852	32,343
Held-to-maturity	29,838	52,193	-	82,031
<b>At 31 December</b>	<b>57,329</b>	<b>52,193</b>	<b>4,852</b>	<b>114,374</b>

## 26. CURRENCY RISK

The Bank's policy is to take no significant foreign exchange risk, but to invest its SDR denominated capital and reserves in the SDR constituent currencies at the appropriate weights.

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	Romania lei	Special drawing right	Total
<b>Assets</b>							
Cash and bank balances	2,823	1,854	425	208	10		5,320
Placements with financial institutions							0
Investment securities	40,793	11,452	11,227	36,976			100,448
Derivative financial instruments						238	238
Loans	357,914	107,718					465,632
Impairment losses on loans	(22,024)	(3,822)					(25,846)
Equity investments	4,467	1,852			1,571		7,890
Other assets	6,117	3,103	168	537		456	10,381
Net property and equipment						308	308
Net intangible assets						449	449
<b>Total assets</b>	<b>390,090</b>	<b>122,157</b>	<b>11,820</b>	<b>37,721</b>	<b>1,581</b>	<b>1,451</b>	<b>564,820</b>
<b>Liabilities</b>							
Borrowings	221,733	10,062					231,795
Payables and accrued interest	1,219	940					2,159
Deferred income						3,200	3,200
Members' equity						327,666	327,666
<b>Total liabilities and equity</b>	<b>222,952</b>	<b>11,002</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>330,866</b>	<b>564,820</b>
Net assets (liabilities)	167,138	111,155	11,820	37,721	1,581	(329,415)	0
Derivative financial instruments	(34,712)	13,973	21,892	0	(915)	(238)	0
<b>Net currency balance at 31 December 2007</b>	<b>132,426</b>	<b>125,128</b>	<b>33,712</b>	<b>37,721</b>	<b>666</b>	<b>(329,653)</b>	<b>0</b>
Correct SDR weights*	131,989	125,903	34,048	37,713	0	329,653	
Currency position at 31 December 2007	437	(775)	(336)	8	666	0	
<b>Net currency balance at 31 December 2006</b>	<b>134,577</b>	<b>113,764</b>	<b>32,892</b>	<b>37,552</b>	<b>0</b>	<b>(318,785)</b>	<b>0</b>

\* As per IMF rule (effective as of 1 January 2005)

In order to minimize exchange rate related risks the Bank matches, to the extent practicable, the lending obligations in any one currency (after swap activities) with liabilities in the same currency. To avoid currency mismatches, borrowers are required to service their loans in the currencies disbursed by the Bank. It is Bank policy to minimize currency fluctuations on its capital by matching the currency composition of its net assets to that of the SDR basket.

## 27. 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.

The amounts below for total assets and total liabilities are based on undiscounted contractual cash flows.

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
<b>Assets</b>							
Cash and bank balances	5,320						<b>5,320</b>
Placements with financial institutions							<b>0</b>
Investment securities	55,886			44,562			<b>100,448</b>
Derivative financial instruments		238					<b>238</b>
Loans	21,146	25,959	99,893	246,186	72,448		<b>465,632</b>
Impairment losses on loans						(25,846)	<b>(25,846)</b>
Equity investments						7,890	<b>7,890</b>
Other assets	1,109	9,205				67	<b>10,381</b>
Net property and equipment						308	<b>308</b>
Net intangible assets						449	<b>449</b>
<b>Total undiscounted assets</b>	<b>83,461</b>	<b>35,402</b>	<b>99,893</b>	<b>290,748</b>	<b>72,448</b>	<b>(17,132)</b>	<b>564,820</b>
<b>Liabilities</b>							
Borrowings	747		95,029	131,003	5,016		<b>231,795</b>
Payables and accrued interest		1,462	697				<b>2,159</b>
Deferred income	3,200						<b>3,200</b>
Members' equity						327,666	<b>327,666</b>
<b>Total undiscounted liabilities and equity</b>	<b>3,947</b>	<b>1,462</b>	<b>95,726</b>	<b>131,003</b>	<b>5,016</b>	<b>327,666</b>	<b>564,820</b>
<b>Liquidity position at 31 December 2007</b>	<b>79,514</b>	<b>33,940</b>	<b>4,167</b>	<b>159,745</b>	<b>67,432</b>	<b>(344,798)</b>	<b>0</b>
<b>Liquidity position at 31 December 2006</b>	<b>87,268</b>	<b>32,099</b>	<b>27,301</b>	<b>161,590</b>	<b>25,559</b>	<b>(333,817)</b>	<b>0</b>

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

## 28. 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.

Expressed in SDR (000)	Interest bearing					Non-interest bearing	Total
	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years		
<b>Assets</b>							
Cash and bank balances	5,319					1	<b>5,320</b>
Placements with financial institutions							<b>0</b>
Investment securities	55,886	1,444		43,118			<b>100,448</b>
Derivative financial instruments						238	<b>238</b>
Loans	126,564	192,890	140,951	5,227			<b>465,632</b>
Impairment losses on loans						(25,846)	<b>(25,846)</b>
Equity investments						7,890	<b>7,890</b>
Other assets						10,381	<b>10,381</b>
Net property and equipment						308	<b>308</b>
Net intangible assets						449	<b>449</b>
<b>Total assets</b>	<b>187,769</b>	<b>194,334</b>	<b>140,951</b>	<b>48,345</b>	<b>0</b>	<b>(6,579)</b>	<b>564,820</b>
<b>Liabilities</b>							
Borrowings	32,424	190,056	9,315				<b>231,795</b>
Payables and accrued interest						2,159	<b>2,159</b>
Deferred income						3,200	<b>3,200</b>
Members' equity						327,666	<b>327,666</b>
<b>Total liabilities and equity</b>	<b>32,424</b>	<b>190,056</b>	<b>9,315</b>	<b>0</b>	<b>0</b>	<b>333,025</b>	<b>564,820</b>
<b>Interest rate risk at 31 December 2007</b>	<b>155,345</b>	<b>4,278</b>	<b>131,636</b>	<b>48,345</b>	<b>0</b>	<b>(339,604)</b>	<b>0</b>
<b>Interest rate risk at 31 December 2006</b>	<b>156,159</b>	<b>58,325</b>	<b>116,988</b>	<b>0</b>	<b>0</b>	<b>(331,472)</b>	<b>0</b>

The sensitivity analysis of net interest income for the Bank over a one-year period for 2007 would show that the Bank's results would be affected by an amount of SDR 1,640 thousand do to an increase or decrease of 0.5% change in interest rates. Over a one-year period for 2006 would be affected by an amount of SDR 1,590 thousand do to an increase or decrease of 0.5% change in interest rates.



## 29. STAFF RETIREMENT PLAN

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, under the defined benefit scheme. Also upon retirement, a staff member will be entitled to receive in cash the full balance standing to the credit of his/her individual account for the second and third pillars.

### Defined Benefit Scheme

The defined benefit scheme covers all eligible employees of the Bank. A qualified actuary performs an actuarial valuation of this scheme at each end of year using the projected unit method, which is rolled forward to the following year mid term accounts. The most recent valuation date was 31 December 2007. The present value of the defined benefit obligation and current service cost was calculated using the projected unit credit method.

Expressed in SDR (000)	At 31 December 2007	At 31 December 2006
Amounts recognised in the balance sheet		
Present value of the defined benefit obligations	3,632	3,347
Fair value of plan assets	(4,268)	(2,594)
	(636)	753
Unrecognised actuarial gains (losses)	1,333	108
Net liability	697	861
Expenses for the year	849	1,114
Past service obligation	209	130
Contributions paid	(1,058)	(1,414)
<b>At end of year</b>	<b>697</b>	<b>691</b>
Amounts recognised in the income statement		
Current service cost	580	553
Interest cost	197	114
Expected return on plan assets	(165)	(114)
Past service obligation	237	561
<b>Total included in administrative expenses</b>	<b>849</b>	<b>1,114</b>
Principal actuarial assumptions used		
Discount rate	5.50%	4.00%
Expected return on plan assets	4.20%	4.20%
Future salary increases	3.50%	2.30%
Average remaining working life of employees	16 years	14 years

### Defined Contribution Scheme

The pension expense under this scheme was SDR 363 thousand (2006: SDR 330 thousand) and is included in "Administrative expenses".

### Greek State Social Insurance Fund

The pension expense of staff that is alternatively entitled to retirement benefits from this fund was SDR 111 thousand (2006: SDR 81 thousand) and is included in "Administrative expenses".

### **30. 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 year included in “Administrative expenses” totalled SDR 728 thousand (2006: SDR 650 thousand). The Hellenic Republic will grant the rental already being reimbursed amounting to SDR 728 thousand.

### **31. FAIR VALUE**

The Bank’s balance sheet approximates to fair value in all financial assets and financial liabilities. At 31 December 2007 the Bank has not issued any debt securities that would be used for borrowing requirements.

### **32. CAPITAL MANAGEMENT**

The Bank maintains an actively managed capital to cover risks in its activities. The adequacy of the Bank’s capital is monitored. The primary objective of the Bank’s capital management is to ensure that the Bank complies with capital requirements and maintains an adequate capital ratio in order to support its continuous activities.

On 2 December 2007 the Board of Governors approved an increase in the authorised capital of the Bank from SDR 1 billion to SDR 3 billion. Additionally, the Board of Governors authorised the offering of SDR 1 billion to the existing Member States for subscription, with the objective of increasing subscribed capital to a total of SDR 2 billion.

### 33. 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 2007 the Bank administered and audited the Technical Cooperation Special Fund (the “Fund”), whose 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 2007 and 2006 is shown below.

Expressed in SDR (000)	At 31 December 2007	At 31 December 2006
Statement of movements		
Balance brought forward	581	588
Contribution received	-	-
Interest and other income	18	14
Less: disbursements	(274)	(54)
Less: operating expenses	(2)	(2)
Foreign exchange movements	38	35
<b>Balance of available funds</b>	<b>361</b>	<b>581</b>
Balance sheet		
Assets		
Placements with other financial institutions	361	581
<b>Total Assets</b>	<b>361</b>	<b>581</b>
Liabilities		
Allocated fund balance	-	-
Unallocated fund balance	361	581
<b>Total Liabilities and Contributor Resources</b>	<b>361</b>	<b>581</b>

### 34. POST BALANCE SHEET EVENTS

There are no material post-balance sheet events that would require disclosure or adjustment to these financial statements.



# Independent Auditor's Report

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

We have audited the accompanying financial statements of the “Black Sea Trade and Development Bank”, which comprise the balance sheet as at 31 December 2007, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

### **Auditor's Responsibility**

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

### **Opinion**

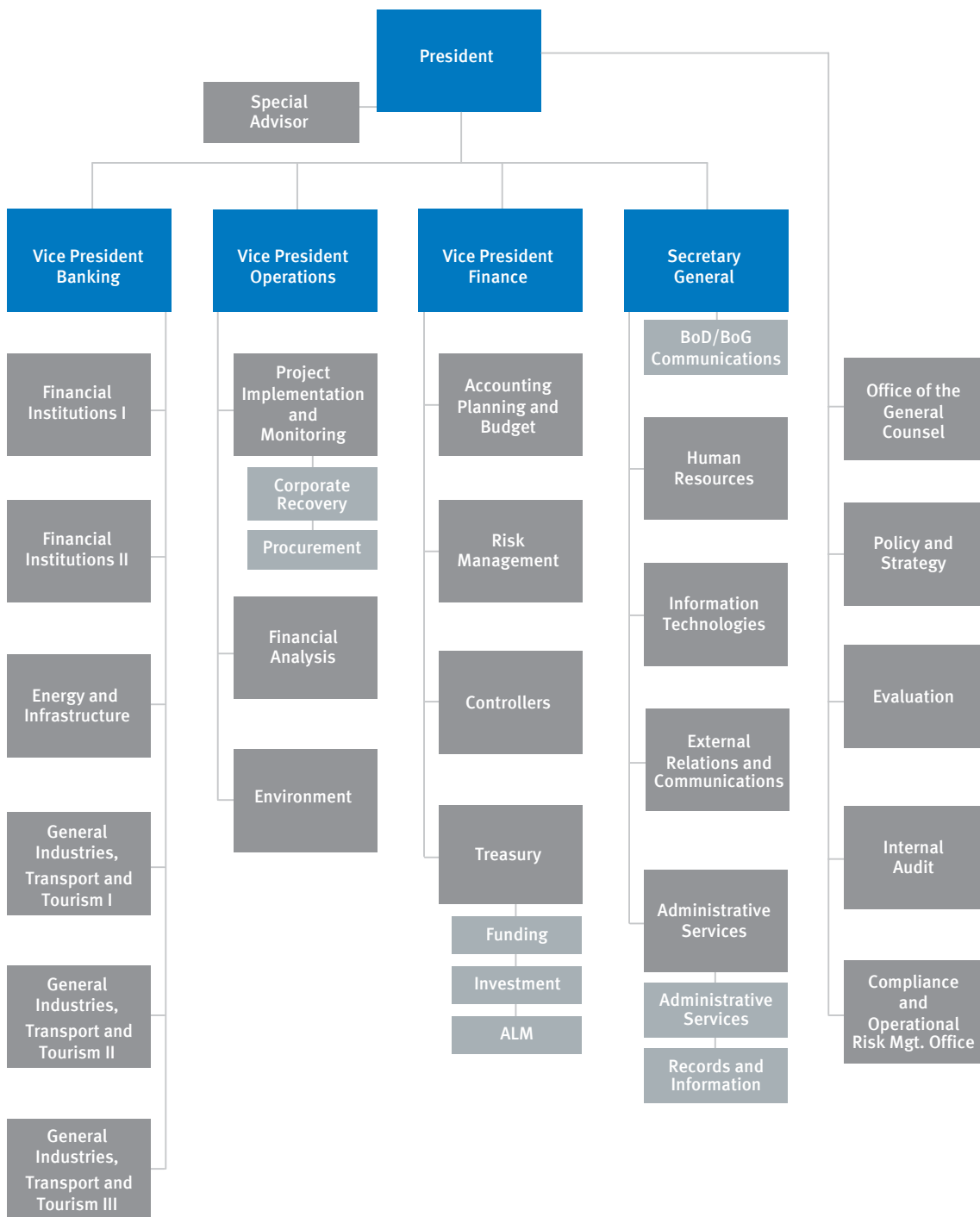
In our opinion, the financial statements present fairly, in all material respects, the financial position of the “Black Sea Trade and Development Bank” as of 31 December 2007, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

**Ernst and Young,**  
Athens, Greece, 4 April 2008

Annex I

# ORGANIZATIONAL CHART

As of 31 December 2007



## Annex II

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