Black Sea Trade & Development Bank

Meeting Regional Expectations

Annual Report **2017**

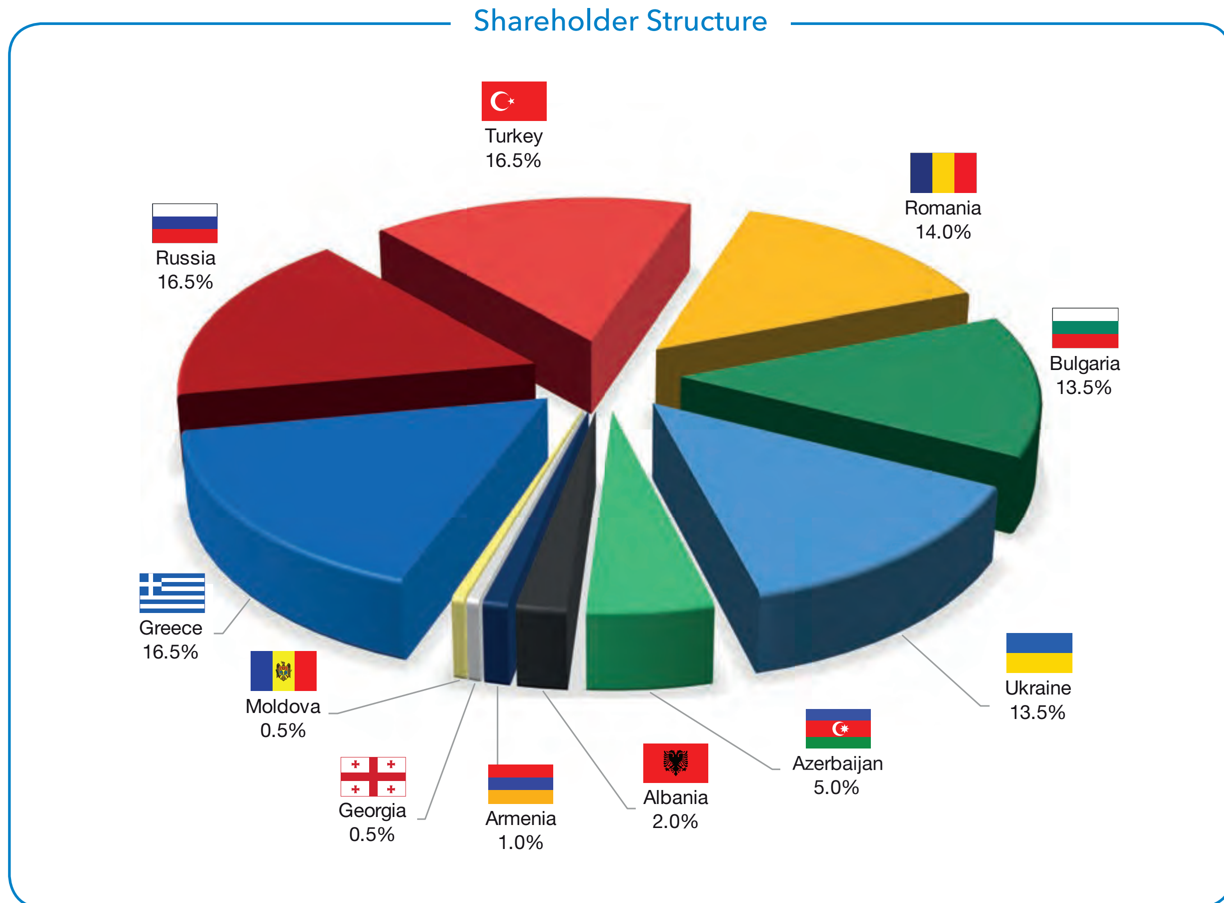
Contents

Who We Are	4
Highlights of 2017	5
To the Board of Governors	7
Board of Governors	8
Board of Directors	9
Audit Committee and Management	10
Statement by the President	11
Economic Overview of the Black Sea Region in 2017	13
BSTDB in the Black Sea Region Assessment of Progress –	
Medium-Term Strategy and Business Plan 2015–2018	24
Portfolio Description	30
Selected BSTDB Financings	35
Addressing Sustainability	42
Annual Evaluation Overview	45
Use of Resources	49
Financial Statements for the Year Ended 31 December 2017	60
Responsibility for external financial reporting	61
Independent Reasonable Assurance	62
Income Statement	63
Statement of Other Comprehensive Income	64
Statement of Financial Position	65
Statement of Changes In Members' Equity	66
Statement of Cash Flows	67
Notes To The Financial Statements	68
Independent Auditor's Report	122
ANNEX A Organizational Chart	126
ANNEX B Contact BSTDB	127

Who We Are

The Black Sea Trade and Development Bank (BSTDB), an international financial institution with headquarters in Thessaloniki, Greece, was established by Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Turkey, and Ukraine. BSTDB started operations in June 1999 and has an authorized capital of EUR 3.45 billion and a subscribed capital of EUR 2.3 billion.

Shareholder Structure



BSTDB supports economic development and regional cooperation in the Black Sea Region through loans, guarantees, and equity participation in private enterprises and public entities in member countries.

The Bank is managed by a Board of Governors, a Board of Directors, a President, three Vice Presidents and a Secretary General. The Board of Governors is the Bank's highest decision making body. It comprises one Governor and one Alternate Governor appointed from each of the Bank's 11 Member States. Subject to the Board of Governors' overall authority, the Board of Directors is responsible for the direction of the Bank's general operations. The President is the Chairman of the Board of Directors and the Bank's chief executive. The President, the Vice Presidents and the Secretary General form the Management Committee and represent the Bank's senior management.

Highlights of 2017

- In 2017, responding to a stronger demand for BSTDB financing amid the revived economic activity in the Black Sea Region, the Board of Directors approved a record EUR 525 million in new operations, showing an increase of 21% from 2016. The Bank's commitments (signed operations) reached EUR 401 million, a 7.3% rise over 2016 levels.
- Notable progress was made increasing the share of real sector financing in member countries as set forth in the BSTDB Medium-Term Strategy for 2015–2018. After a long period of significant exposure, to predominantly financial institutions, the Bank has been gradually increasing the portfolio share of real sector operations over the past three years. It reached 64.3% at the end of 2017, exceeding the target set for the end of the strategy period. This development has attested the Bank's ability to address the financing needs of small- and medium-sized companies not only through financial intermediaries in member countries, but also directly. The portfolio in the real sector was significantly diversified. Furthermore, in 2017, the Bank continued the trend of recent years towards a more balanced geographical distribution of the portfolio across member countries, one of its key strategic objectives.
- At the end of 2017, BSTDB's total portfolio outstanding balance stood at EUR 1.17 billion. For the 13th consecutive year, the Bank maintained profitability, while operating income reached a record EUR 38.4 million. This was achieved while maintaining high operational portfolio quality, with non-performing loans stable, low and appropriately provisioned.
- As part of its initiative to help develop local currency markets in member countries, BSTDB issued a debut AMD 2 billion bond in Armenia in June 2017. At the year end, the Bank had outstanding loans in Armenian Dram, Georgian Lari and Russian Rubles totaling 4.6% of its outstanding loan portfolio.
- The Management decided to adopt the IFRS 9 accounting standard one year early as of January 1, 2017, ahead of most financial institutions. Under the new standard, BSTDB will move from an incurred loss model to a forward looking one for the assessment of impairment, thus allowing more accurate reporting on the Bank's portfolio quality.
- Aiming to improve investment access for small- and medium-sized enterprises (SMEs) in the Black Sea Region, BSTDB, together with the Secretariat of the Organization of the Black Sea Economic Cooperation, has contributed to the establishment of the Black Sea Project Promotion Facility, utilizing funds provided by the Russian Federation. The USD 1 million facility will finance technical assistance services related to the preparation of: feasibility studies, business plans, due diligence analysis, creation of partnerships for activities mostly related to energy efficiency and renewables, environmentally-friendly technologies, infrastructure, trade exchanges, and knowledge sharing. In September 2017, for the first project submitted by BSTDB, the facility funded an environmental and social due diligence evaluation for a pulp and paper producer.
- In 2017, the Bank strengthened synergies with the global and regional development and business communities to facilitate co-financing of operations in the Region and the exchange of information and best practices. BSTDB has granted Observer Status to the Asian Development Bank (ADB), which is expected to boost cooperation in the common countries of operation: Armenia, Azerbaijan and Georgia. ADB became BSTDB's twelfth Observer institution. During the year, five Memorandums of Understanding were signed with partner entities, including the Global Infrastructure Hub, the Russian Federal Corporation for Small- and Medium-Sized Entrepreneurship, the National Bank of Moldova, and the Chambers of Commerce and Industry of Moldova and Ukraine.

- BSTDB has actively contributed to multilateral consultation mechanisms established by development finance institutions aimed at facilitating knowledge sharing and promoting developmental effectiveness. During the year, the Bank chaired and hosted IFIs meetings on Environmental and Social Standards, International Accountability Mechanisms, Information Disclosure and Stakeholder Engagement, as well as meetings of the European Chief Compliance Officers and the Heads of Procurement of Multilateral Development Banks.
- The Bank has enhanced its involvement in international efforts to tackle climate change. In November, BSTDB became Observer to the Conference of the Parties of the United Nations Framework Convention on Climate Change. In December, BSTDB signed a Joint Statement by member institutions of the International Development Finance Club and major Multilateral Development Banks in an effort to collectively align their financial flows with the 2015 Paris Agreement on Climate Change.
- BSTDB's achievements in different areas have been recognized by the international community. The Bank was named the winner of the 'Best Development Financing Bank Southeast Europe 2017' by the Global Banking and Finance Review Magazine (UK) and recognized as the 'Best Regional Development Bank, Southeast Europe 2017' by the International Finance Magazine (UK). Furthermore, BSTDB's IT team received the 2017 Enterprise Information Management Innovation Award from Opentext at the annual Enterprise World conference in Toronto, for an IT solution created for the Bank's Legal Department.

To the Board of Governors

In accordance with Article 35 of the Agreement Establishing the Black Sea Trade and Development Bank and Section 10 of its By-Laws, I submit to the Board of Governors the Bank's Annual Report for 2017 as endorsed by the Board of Directors. The Nineteenth Annual Report contains the Bank's financial statements; separate financial statements for the operations of the Bank's Special Funds have also been issued, as prescribed in Section 12 of the Bank's By-Laws.

Ihsan Ugur Delikanli

President
Chairman of the Board of Directors

Board of Governors

As of 31 December 2017

Republic of Albania

Governor:	Mr. Erjon LUCI, Deputy Minister of Finance
Alternate Governor:	Ms. Ilda MALILE, General Director, General Directorate of Public Debt, Borrowing Department, Agreement Division, Ministry of Finance

Republic of Armenia

Governor:	Mr. Arthur JAVADYAN, Chairman, Central Bank of Armenia
Alternate Governor:	Mr. Andranik GRIGORYAN, Deputy Head, Financial System Stability & Development Department, Central Bank of Armenia

Republic of Azerbaijan

Governor:	Mr. Samir SHARIFOV, Minister of Finance
Alternate Governor:	Mr. Shahin MUSTAFAYEV, Minister of Economy

Republic of Bulgaria

Governor:	Ms. Marinela PETROVA, Deputy Minister of Finance
Alternate Governor:	Ms. Gergana BEREMSKA, Director, International Financial Insitutions and Cooperation Directorate, Ministry of Finance

Georgia

Governor:	Mr. Koba GVENETADZE, President, National Bank of Georgia
Alternate Governor:	Mr. Dmitry KUMSISHVILI, Minister of Finance

Hellenic Republic

Governor:	Mr. Dimos PAPADIMITRIOU, Minister of Economy and Development
Alternate Governor:	position vacant

Republic of Moldova

Governor:	Mr. Octavian ARMASU, Minister of Finance
Alternate Governor:	position vacant

Romania

Governor:	Mr. Ionut MISA, Minister of Public Finance
Alternate Governor:	Mr. Gyorgy ATTILA, Secretary of State, Ministry of Public Finance

Russian Federation

Governor:	Mr. Sergey STORCHAK, Deputy Minister of Finance
Alternate Governor:	Mr. Igor KOVAL, Director, Department for Investment Policy and Development of Public-Private Partnership, Ministry of Economic Development

Republic of Turkey

Governor:	Mr. Osman CELIK, Undersecretary of Treasury Undersecretariat of Treasury
Alternate Governor:	position vacant

Ukraine

Governor:	position vacant
Alternate Governor:	Mr. Volodymyr KUCHYN, Head, Office for European Integration & International Programs, National Bank of Ukraine

Board of Directors

As of 31 December 2017

Republic of Albania

Director:	Ms. Gelardina PRODANI, General Secretary, Ministry of Finance
Alternate Director:	position vacant

Republic of Armenia

Director:	Mr. Davit ANANYAN, Deputy Minister of Finance
Alternate Director:	Mr. Nerses MKRTCHIAN, Advisor, Ministry of Foreign Affairs

Republic of Azerbaijan

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

Republic of Bulgaria

Director:	Ms. Milena BOIKOVA, Director, Government Debt & Financial Markets Directorate Ministry of Finance
Alternate Director:	Mr. Nikola SHERLETOV, Parliamentary Secretary, Ministry of Finance

Georgia

Director:	Mr. Nikoloz GAGUA, Deputy Minister of Finance
Alternate Director:	Mr. Giorgi TABUASHVILI, First Deputy Minister of Finance

Hellenic Republic

Director:	Mr. Ilias XANTHAKOS, Secretary General, Ministry of Economy and Development
Alternate Director:	position vacant

Republic of Moldova

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

Romania

Director:	Ms. Diana PELIGRAD BLINDU, Senior Advisor, General Directorate for International Financial Relations, Ministry of Public Finance
Alternate Director:	Mr. Stefan PETRESCU, Deputy Director General, General Directorate for International Financial Relations, External Public Finance, Ministry of Public Finance

Russian Federation

Director:	Mr. Evgeny STANISLAVOV, Director, Department of Economic Cooperation Ministry of Foreign Affairs
Alternate Director:	position vacant

Republic of Turkey

Director:	Mr. Raci KAYA, Ph.D., Deputy Undersecretary of Treasury, Undersecretariat of Treasury
Alternate Director:	Mr. Kemal Cagatay IMIRGI, Acting Director General, Foreign Economic Relations, Undersecretariat of Treasury

Ukraine

Director:	Mr. Valeriy PIATNYTSKYI, Advisor to the Prime Minister, Cabinet of Ministers of Ukraine
Alternate Director:	Mr. Vitaliy LISOVENKO, Governmental Envoy for Public Debt Management, Ministry of Finance

Audit Committee

As of 31 December 2017

Ms. Gelardina PRODANI, Director for the Republic of Albania and Chairperson of the Audit Committee

Mr. Davit ANANYAN, Director for the Republic of Armenia and Audit Committee member

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

Mr. Valeriy PIATNYTSKYI, Director for Ukraine and Audit Committee member

Management

As of 31 December 2017

Igor Leshukov	Nina Stavreva	Ihsan Ugur Delikanli	Valentina Siclovan	Serafeim Tsokas
Vice President Banking	Vice President Operations	President, Chairman of the Board of Directors	Vice President Finance	Secretary General

Statement by the President

The countries of the Black Sea Economic Cooperation enjoyed one of their better years of growth in 2017, with real GDP for the Region as a whole growing by 3.5% for the year. This represented a robust outturn after several years of declining and/or lackluster growth, demonstrating that all Member States have put economic difficulties behind them which they had faced to varying degrees following the 2008 global financial crisis.

This favorable economic context created both challenges and opportunities for the Black Sea Trade and Development Bank. Increased economic activity led to greater opportunities for financing, while growing bank lending volumes and declining spreads resulted in a compression of lending margins and a much more competitive environment.

Nevertheless, demand for Bank financing was stronger than ever. During 2017 the Bank's Board of Directors approved a record EUR 525 million in new operations, an increase of 21% from 2016, and commitments reached EUR 401 million, a 7.3% rise from 2016 levels. At end 2017 the total portfolio outstanding balance stood at EUR 1.17 billion. Operating income for 2017 reached a record EUR 38.4 million on the strength of robust operational activity and active treasury operations, which were revised in the aftermath of the issuance of a debut benchmark bond for USD 500 million. For the 13th consecutive year, BSTDB maintained profitability, with net income reaching EUR 8.7 million. This was achieved while maintaining high operational portfolio quality, with non-performing loans stable, low and appropriately provisioned, in line with objectives from the Bank's key strategy documents.

While continuing to provide project financing, trade financing, and other long-utilized and well-established products, the Bank expanded considerably the types of instruments with which it supports clients. It continued and expanded its program of local currency financing, introduced in the last few years, funding this lending activity through a variety of innovative structures, including bond issuance and derivative products. The Bank also acted as strategic investor to facilitate a debut bond issuance and access to financial markets for a client. Furthermore, it undertook its first project as an A lender under an A/B loan structure, utilizing yet another way to mobilize external financing for the benefit of the Region.

More importantly, portfolio quality remained high, with non-performing loans down to 2.14% of the loan portfolio outstanding balance at the end of 2017. It also sustained diversity of operations in geographic and sectoral terms. Public sector lending grew from around 3%–10% of the portfolio, and with public sector operations accounting for one sixth of new signings (by volume), this trend is well placed to improve further. Maintaining quality was underscored by the reaffirmation of the Bank's A2 credit rating by Moody's and A minus by Standard and Poor's, the highest ratings of any entity based in the Black Sea Region and nearly six notches higher than the average of its Member States.

The Bank expanded its range of contacts internationally. BSTDB became an Observer to the United Nations Framework Convention on Climate Change and BSTDB granted Observer Status to the Asian Development Bank. BSTDB also concluded five new cooperation agreements with partner organizations that share an interest in promoting economic progress in the Black Sea Region. From an operational perspective, the signing of the Black Sea Project Promotion Facility with the Russian Federation was particularly important. As a result, BSTDB's clients will gain access to a new facility that provides technical assistance for project preparation activities and related studies.

Shareholder support played a key role in making these achievements possible. The Bank's members promoted its presence in international events and key regulatory forums, and met ongoing capital contribution requirements; in some cases even exceeding the requirements substantially ahead of deadlines. Moreover, the shareholders enthusiastically backed BSTDB's proactive adoption of the new IFRS 9 accounting standard one year early, as of 1 January 2017. The Bank's move was well ahead of most other financial institutions and involves taking a forward-looking approach in assessing impairment, allowing more accurate evaluation and measurement of portfolio quality.

As the Bank turns its attention to 2018, the last year implementing the four-year Medium-Term Strategy and Business Plan 2015–2018, it is useful to reflect on the many accomplishments of the first three years. The Bank's Board of Directors approved 71 new operations totaling EUR 1.45 billion, of which 63 were signed for a total of EUR 1.25 billion. Both of these figures are more than 40% above the MTSBP's targeted levels, and together with disbursements, which amounted to EUR 1.23 billion or 36% above projected levels, bear testimony to the healthy demand from banks, firms and agencies active in the Black Sea Region. Just as importantly, in the first three years of the plan, BSTDB exceeded its upward revised four-year targets for operational activity in four member countries, and was well on its way to meeting or exceeding its operational objectives in the other seven member states.

Beyond operational activity, the Bank organized extremely well-attended Business Forum events around its Annual Meetings in Georgia, Greece and Moldova. Host countries were able to profile recent achievements and future investment priorities, and local businesses could network and discuss business opportunities with investors from abroad and international financing institutions. The Bank concluded a total of 13 new cooperation agreements and memoranda of understanding with organizations interested in working in the Region and promoting the Bank's dual mandate objectives of economic development and regional cooperation. BSTDB also hosted a number of conferences for working groups of international financial institutions in thematic areas such as the environment, governance and evaluation, as well as local currency lending - a rapidly growing priority area in many countries. Last but not least, the Bank established its presence on social media, with more than 13,000 followers by the end of 2017, providing yet another platform for information sharing and networking focused on the Black Sea Region.

One of the Bank's key objectives for the 2015–18 period was to become a communicating and learning organization internally, as well as with the Black Sea Region, sharing knowledge and exchanging information about the Region. The aforementioned achievements show tremendous progress in this area, laying a solid foundation to build on. The Bank is thus well on its way to achieving its key strategic and operational objectives. It has established a base from which it will continue to grow and provide financing and risk mitigation solutions for its clients, as well as add value for its Member State shareholders.

As this is the final Annual Report which I have the honor to present as Chairman of the Board of Directors and President of BSTDB, I would like to express my appreciation for the excellent level of cooperation with the shareholders, with fellow Management and with the staff that I have enjoyed, and to share my every confidence that the new Management will similarly guide BSTDB forward to develop and grow with the same aspirations and determination in coming years.

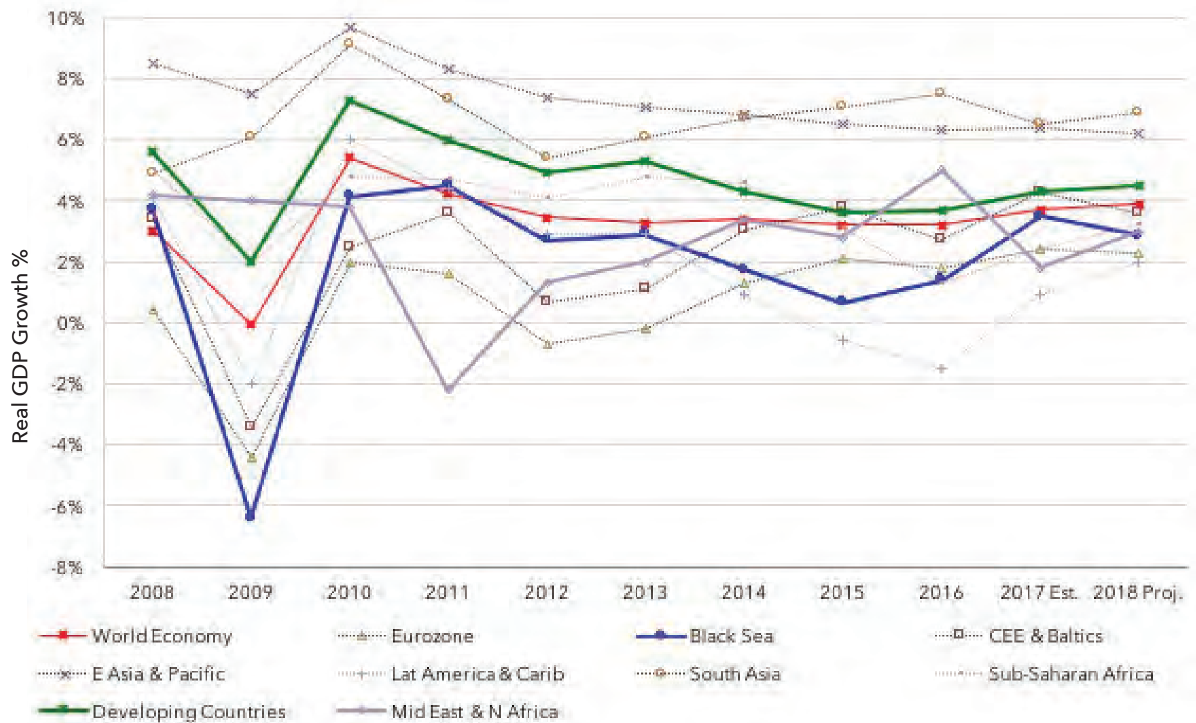
Ihsan Ugur Delikanli

President
Chairman of the Board of Directors

Economic Overview of the Black Sea Region in 2017[1]

The Black Sea Region[2] enjoyed one of its best years in 2017, in terms of economic activity, since the pre-financial crisis boom period in the 2000s. Economic growth was robust, all countries posted positive outturns despite case-by-case variations, and the basis of growth was diverse and broad, relying on a number of factors.

Figure 1: Global Real GDP Growth Since 2008, Broken Down by Region



Source: National Statistical Agencies, World Bank & IMF-IFS

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 reports of the World Bank, the IMF's *World Economic Outlook* publications (and their updates) and the Economist Intelligence Unit. As many figures at the time of writing represent estimates for 2017, actual final figures may differ in detail, but the overall trends discussed in this section will not be altered.

2 Comprised of the 12 member countries of the Organization of the Black Sea Economic Cooperation (BSEC): Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, Serbia, Turkey, Ukraine.

Figure 1 shows how the Black Sea Region compares to the world economy and other regional groupings. The global economy experienced an upturn in growth in 2017, reaching an estimated 3.7%, which represented a pick-up of over half a percentage point over the growth rate of the previous two years.

Among the various regions, the Black Sea was in the middle of the pack, with regional GDP growing at 3.5%, just a shade off the global rate. The Black Sea lagged substantially behind the high growth rates achieved in Asia, as both the South Asia region and the East and Pacific region grew at approximately 6.5%, the highest rates globally by a substantial margin, and the reason why Asia has been considered the main engine of global economic growth. The Black Sea also lagged behind the growth achieved by the Central and Eastern European and Baltic states (CEE & Baltics)[3], most of whom joined the European Union in 2004 and, as former 'transition' countries, are often compared to the countries of the greater Black Sea Region. The CEE & Baltics posted a fourth consecutive year of high positive growth which exceeded the level achieved by the Black Sea Region; for 2017 the rate reached an impressive 4.3%.

With respect to other regions, the Black Sea's outturns compared quite favorably. Regions with predominantly developing countries, such as Latin American and the Caribbean, the Middle East and North Africa, and Sub-Saharan Africa, all posted positive growth, but at rates below those of the Black Sea Region. The European Union, which collectively comprises the largest commercial partner for Black Sea countries and the principal source of financing and investment, enjoyed an uptick in growth to 2.4% for 2017. This upturn exceeded earlier projections for the EU and was termed an 'upside growth surprise'[4], accounting for much of the observed increase in growth for the global economy. In other words, the stronger than expected growth posted by the EU benefited world economic growth at the margin. The countries of the Black Sea Region (along with CEE & Baltics) were among the principal beneficiaries of the EU growth upturn. The increase in EU demand translated directly into stronger export growth; increased EU investor appetite led to heightened investment and financing flows into the Black Sea Region.

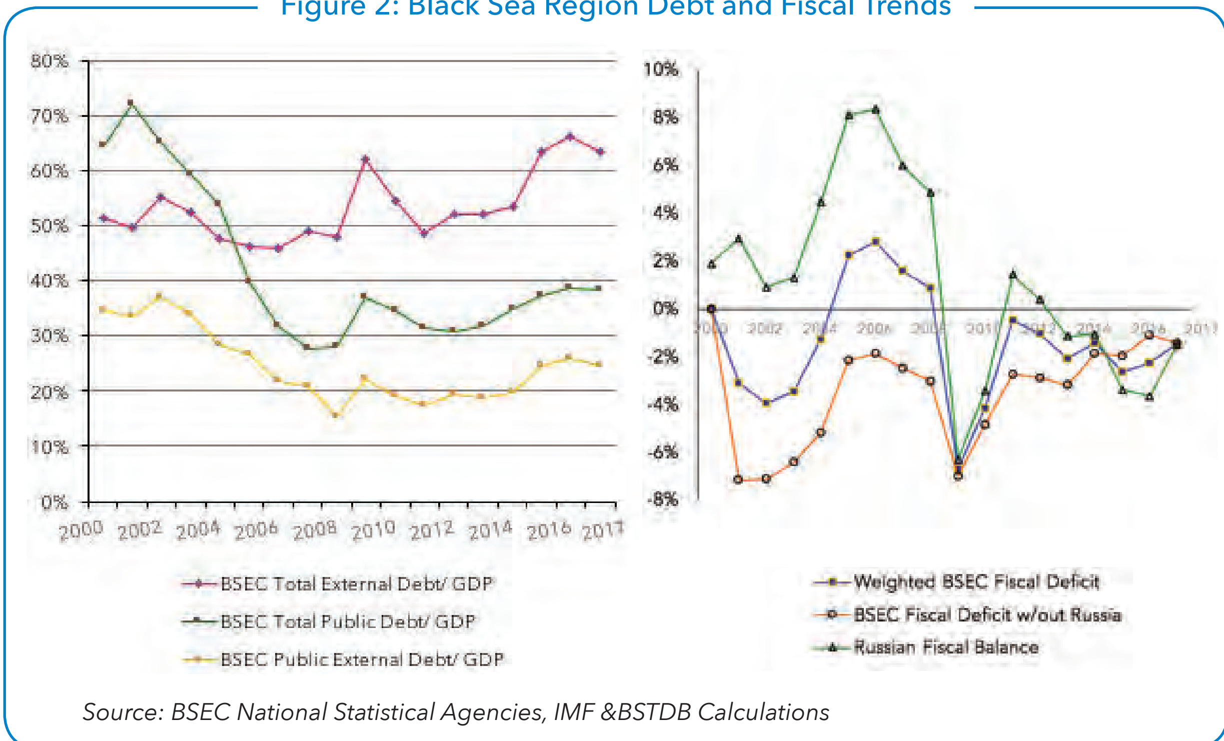
As Figure 1 shows, the Black Sea Region's economic performance represented a substantial improvement relative to that achieved in recent years. Indeed, growth momentum picked up over the course of the year, with the final results more than double the original projections for 2017 (which were on the order of 1.5%). This represented a welcome turnaround from the anemic performance of recent years when the region experienced negative spillover events from 2012–2016 from a series of exogenous events including the Eurozone crisis, the collapse of commodity prices in 2014–2015 and considerable geopolitical turmoil, especially in the neighboring Middle East. Thus, after several years of slowing performance, followed by a small recovery that began in 2016, 2017 proved to be a very successful year.

The economic growth across the region was broad-based, founded on solid underlying macroeconomic indicators. Indeed, 2017 represented the continuation of policies to which Black Sea countries have been committed for years as they have sought to eliminate imbalances, reduce vulnerabilities, increase resilience and establish a solid basis for growth. Countries implemented prudent fiscal and monetary policies to enhance their economic standing as well as mitigate fears of potential weaknesses that might leave them exposed or with difficulty in adapting to possible adverse global developments. But while countries exercised sensible and pragmatic policies over the elements of economic policy they controlled. They faced much greater difficulty dealing with negative perceptions of the region, a general attitude of uncertainty, and exogenous global developments (such as key currency monetary policies, commodity prices, etc.) over which they had zero influence.

3 EU members since 2004: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia; and Croatia, which joined the EU in 2014.

4 IMF, World Economic Outlook Update, January 2018

Figure 2: Black Sea Region Debt and Fiscal Trends



Source: BSEC National Statistical Agencies, IMF &BSTDB Calculations

For example, Figure 2 shows regional trends in debt and national budget balances. The left-hand chart shows a long-term declining public debt trend, including foreign currency public debt, while overall external debt (for the private sector as well as the public sector) has risen over the past two decades, but at a more gradual rate. Given that public external debt has declined, it is privately contracted external debt which has risen most rapidly; however, it started out at an extremely low level, around 15% of GDP in 2000, and had risen to around 40% of GDP by end 2017, even as publically contracted external debt had fallen to 24.5% of GDP. These figures stand in contrast to prevailing global trends in advanced and emerging markets over the last decade. In most large markets both public debt levels have risen and total external debt levels have also increased.

It is also worth noting that the most pronounced upward spikes in external debt occurred in 2009 and in 2014–2015. Not coincidentally, these were years of substantial devaluation. First, due to the global financial crisis; second due to the commodity price plunge which roiled many emerging markets and resulted in a sizeable appreciation of the US dollar. In other words, even in these spike periods, the absolute levels of public external debt did not necessarily rise as much as national currency devaluation negatively impacted the GDP denominator, leading to a worsening of the ratio. While there has been some variation from country to country, and there are BSEC countries with high public debt levels that require careful attention, as a rule, the countries of the region have stable or falling public debt levels. In particular, externally contracted public debt levels have been low in absolute terms and have followed a declining path.

The right-hand chart in Figure 2 displays fiscal trends in the Black Sea Region. Even if one excludes Russia, which historically has tended to have high fiscal surpluses that substantially alter the overall picture due to its relative size, fiscal deficits in BSEC countries have generally been low and stable. Moreover, countries have a demonstrated track record of working hard to restore balance following unexpected downturns which temporarily create imbalances, especially as revenues tend to slip while expenditures are more inelastic (often with automatic stabilizers that introduce upward spending pressures during crises) and are thus less amenable to short-term correction. This is precisely what happened during the downturns in 2009 and 2014–2015, with the increase in fiscal expenditures acting as a countercyclical cushion to mitigate some of the decline in private consumption and investment, and thus lessen the negative impact on total economic activity. As the economies recovered, either from the sharp one-off downturn of 2009 or from the longer brewing slowdown in 2014–2015

which had begun even earlier, improvement in government balances soon followed. Results were evident as public deficits narrowed sharply from a combination of spending restraints and revenue collection recovery.

Similarly, other indicators show Black Sea countries' focus on limiting potential vulnerabilities to which they may become exposed. Current accounts have moved towards improved balance, with historically high-deficit countries reining in their imbalances and posting an average weighted deficit below -3.0% of GDP between 2014–2016. In 2017, the current account balance in the high-deficit countries nudged up to nearly -4.0% collectively. This was partly offset by the fact that no country experienced a double digit (i.e. -10%) deficit for the first time in many years, and it was virtually unavoidable given historically low interest rates, declining margins and, consequently, rising financial flows. Similarly, reserve levels and months of import cover have improved in all Black Sea countries. Furthermore, other indicators of potential imbalance such as inflation have also been declining, with many countries absorbing increases that resulted from the 2014–2015 devaluations but then tightening monetary policies and increasing oversight of the financial sector to ensure that credit growth does not become excessive despite the historically loose global financial conditions. Regional domestic credit grew by around 6.7% in 2017, an eminently manageable figure that was much lower than that observed for most advanced and emerging markets.

BSEC countries had followed prudent policies in previous years as well, but experienced weaker results due to unfavorable exogenous factors, and a lingering negative perception that was undeserved. In 2017, global trends played out more positively and the Black Sea Region countries were well-positioned, ready to take advantage of this favorable turnabout, which began in the second half of 2016, and picked up pace last year.

Table 1 shows that all the economies in the Black Sea Region posted positive real GDP growth in 2017. Not since 2007, near the tail end of the 2000s economic boom, had every single BSEC member country posted positive economic growth in the same year. While all countries posted positive growth, the 3.5% average increase in GDP hides a high degree of variation among the countries. Roughly, there were three different categories of perfomers: the high flyers with real GDP growth at or near 7% for the year; the middle performers who achieved positive real GDP growth of anywhere from 2–5%, within plus/minus 1.5% of the regional average; and the weaker performing states who also posted positive real GDP growth, but at less than 2%.

Table 1: Summary of Key Economic Indicators for 2017, by BSEC Member Country

	Real GDP Growth	Inflation	Cur Acct Bal / GDP	Budget/ GDP	Public Debt/ GDP	FDI/ GDP
Albania	3.9%	2.0%	-7.0%	-2.0%	71.5%	7.5%
Armenia	7.5%	1.0%	-3.5%	-2.8%	55.7%	1.9%
Azerbaijan	0.1%	12.9%	4.1%	1.5%	24.3%	16.7%
Bulgaria	3.6%	2.1%	4.6%	0.9%	23.9%	1.9%
Georgia	5.0%	6.0%	-8.6%	-0.9%	42.3%	8.5%
Greece	1.4%	1.1%	-0.7%	-0.6%	178.8%	2.1%
Moldova	4.5%	6.6%	-8.1%	-0.8%	40.6%	2.3%
Romania	6.9%	1.3%	-3.4%	-2.8%	40.5%	2.8%
Russia	1.5%	3.7%	2.2%	-1.5%	17.4%	1.9%
Serbia	1.9%	3.0%	-4.4%	1.2%	70.9%	5.8%
Turkey	7.4%	11.1%	-5.6%	-1.5%	35.8%	1.3%
Ukraine	2.5%	14.4%	-1.9%	-1.3%	89.8%	2.3%
BSEC Region	3.5%	5.8%	-0.9%	-1.5%	38.4%	2.1%

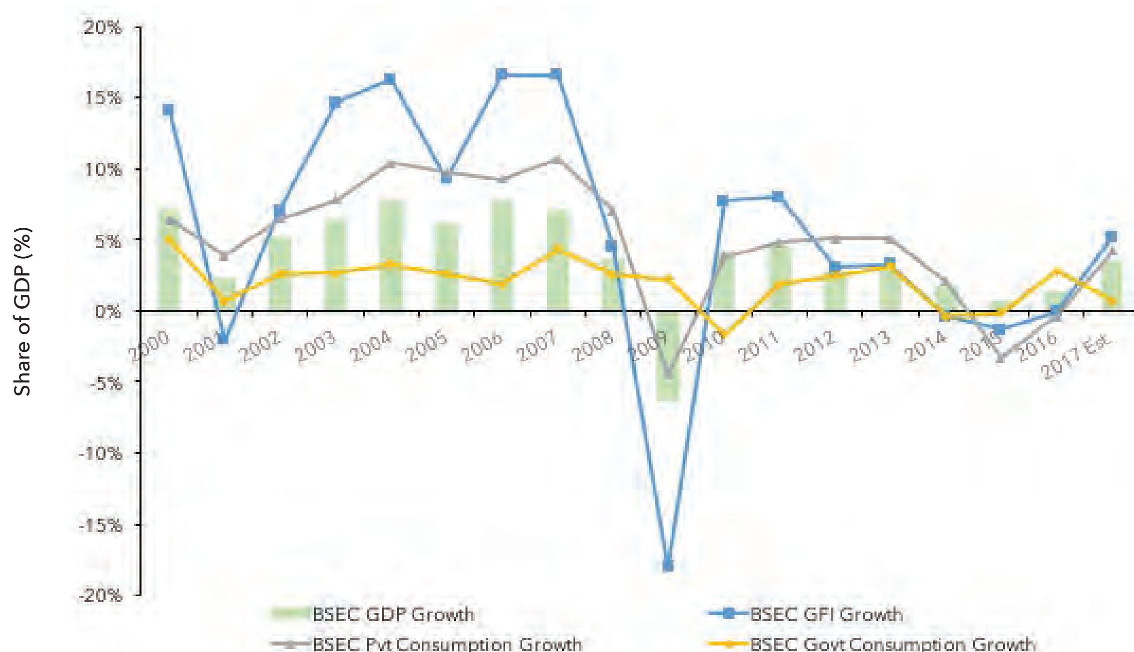
Encouragingly, even the countries with the lowest rates of growth not only posted positive growth, as a rule their performance demonstrated considerable improvement relative to 2016, when several of them had experienced either stagnation or economic contraction. Thus, the countries with apparently lower growth figures are among those with the largest momentum relative to the previous year, having achieved substantial positive turnarounds that place them in solid position to continue the recovery and growth into 2018.

Another interesting feature of the pattern of growth is that in contrast to recent years, it does not lend itself to easy differentiation between those states in the western part of the BSEC Region and those in the eastern part. On the whole, Western BSEC countries, benefiting from a greater degree of integration with the markets of the resurgent European Union, did post higher growth rates for the year than Eastern BSEC. Nevertheless the geographic pattern of countries with low, medium and high growth was mixed, with no preponderance of countries in any one 'category'. There were low, medium and high outturn countries in the western as well as the eastern part of the BSEC Region.

This lack of geographic differentiation diverges from the pattern of previous years, where, an evident distinction had arisen from 2011–2016, the countries in the western part of the BSEC Region followed a different growth cycle to those in the eastern part.

As a result of spillover economic effects from the Eurozone crisis, in 2011–2012 the western countries experienced economic difficulties that resulted in notably worse outcomes, while the eastern states benefited from the post-crisis recovery and rising commodity prices. However, nascent recovery in EU markets, together with the European Central Bank's programs of quantitative easing, resulted in a pick-up in activity in Western BSEC in 2013–2015. The eastern part of the BSEC Region was slowed by softening commodity prices, particularly for energy, and uncertainties in financial markets created by US monetary policy and the sharp appreciation of the US dollar. This put downward pressure on most domestic currencies and created self-fulfilling imbalances. Despite the existence of differing business cycles, the recovery of 2016 picked up the entire Black Sea Region and continued into 2017.

Figure 3: Black Sea Region GDP Growth by Key Component



Sources: BSEC Statistical Agencies, IMF-IFS, EIU, BSTDB Calculations

Figure 3 lays out the factors underlying the region's economic performance. Government consumption grew by only 0.7%, a figure consistent with the efforts at fiscal consolidation discussed earlier and depicted in Figure 2, as governments took advantage of rising economic activity in the broader economy to scale back their own rate of expenditure growth, and to increase revenues in order to improve fiscal balance. Private consumption rose 4.2%, picking up on the back of declining unemployment and rising wage growth, with consumer confidence showing marked improvement relative to recent years. Moreover, as it accounts for approximately 60% of GDP, it weighs most heavily in determining economic outcomes.

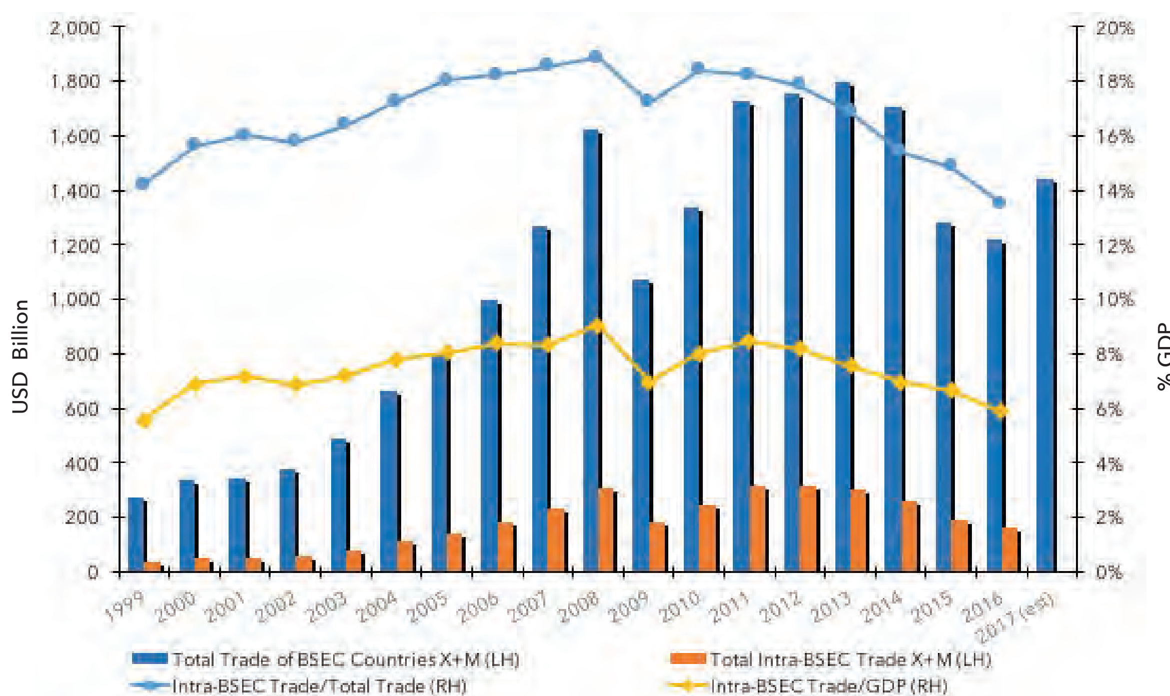
The biggest single growth item was gross fixed investment (GFI), which increased by an estimated 5.2% in the Black Sea Region in 2017. While GFI accounts for only around 15% of GDP overall, it is one of the most important indicators of current and future economic activity. GFI contributes to current economic activity, but is also a primary bellwether of future activity, potential growth in coming years, and confidence in future economic prospects. Investment is a necessary precondition for further growth, particularly in economies which seek to converge towards advanced economies' living standards. In the 2010s', regional investment trends have been worrisome for the most part. GFI crashed, shrinking by 18% in 2009, when the economic downturn which followed the global financial crisis hit the Black Sea Region full force. While most of the region recovered quickly and investment showed a bounce-back effect in 2010 and 2011, from 2012–2016 it declined, stagnated and even contracted as global developments negatively impacted the region.

Despite the resilience which regional economies demonstrated, navigating through difficult periods and remaining dedicated to exercising prudent fiscal and monetary policies and implementing reforms to improve the business environment and consolidate stability, they fared poorly in generating or attracting new investment activity from 2012–2016. Thus, the turnaround in GFI in 2017 was particularly welcome, although the key will be whether it can be sustained and even increased in future years. The conditions are certainly suitable, but investment sentiment can be prickly, and while improvement in one year is positive, it does not yet indicate a trend. That said, there is reason for cautious optimism that the 2017 improvement will be sustained rather than a one-off 'bounce-back'. Business confidence has risen over the last couple of years. Surveys of firms reveal a tendency towards expansion, indicating a favourable outlook for continued healthy investment activity.

The net impact of international trade on GDP is less clear. For the Black Sea Region as a whole, both exports and imports increased in value terms by an estimated 18.8% in 2017 relative to 2016. While the figures are inflated to some extent by the depreciation of the US dollar, the increase was driven primarily by a recovery of commodity prices, and partly from more favorable global conditions for international trade. It reversed several years of declining international trade volumes among the BSEC countries, since, after peaking in 2013 at USD 1.80 trillion, BSEC imports and exports fell 32% between 2014–2016, including a precipitous -25% in 2015 (that was aggravated by US dollar appreciation). In dollar terms at USD 1.45 trillion, 2017's result was still nearly 20% lower than the peak in 2013, although as a share of regional GDP, trade in the Black Sea Region reached an estimated 46.3%, up from 43.5% in 2016 and the second highest level in the region since 2011, when it had reached 46.5% of GDP.

This suggests increased re-engagement with the global economy after a few years of decline, aggravated by geopolitical turmoil and the regime of sanctions and counter-sanctions in 2014–2015 between the United States and the EU on one side, and Russia on the other. While the EU remained the region's principal trading partner, commerce volumes were affected negatively in the immediate aftermath of the conflict. Figure 4 shows the overall trend of international trade for the Black Sea Region. Interestingly, the exports and imports were very balanced, with the overall trade surplus of USD 3.7 billion representing barely 0.1% of regional GDP.

Figure 4: Overview of Black Sea Region Trade Flows - Overall & Intra-Regional[5]



Source: BSEC Member National Statistical Agencies & BSTDB calculations

Turning strictly to trade within the Black Sea Region, Figure 4 shows that while trade flows among BSEC countries grew slowly but steadily for most of the 2000s, up to 2008, the trend during the 2010s decade has been mostly negative. Intra-regional trade crashed in 2009, as was the case for international trade worldwide, and the BSEC Region recovered in 2010–2011 both in value terms, to USD 315 billion, and as a share of GDP (8.5%) and as a share of total trade (18.2%). It then began a steady decline which persisted through 2016, the latest date for which figures are available. While it is likely that intra-regional trade data will increase in US dollar terms for 2017, it is unclear how much it will rise and whether the trends for intra-BSEC trade as a share of total trade and GDP will change for the better. This signifies a rather worrying trend. The region is clearly engaging more with the global economy, and its positive overall trade figures for 2017 suggest that the impact of sanctions and other drags on trade are slowly being left behind. However, the continuing sluggishness in trade among BSEC members has proven more intractable to date.

This represents foregone economic activity and an opportunity cost for the region and its member countries, since regional trade creates considerable win-win prospects for local economies and the firms active therein. Beyond developing closer economic links among partners and the fact that relations among neighbors tend to be more stable and less susceptible to sudden changes in global risk perceptions, proximity reduces transport costs and increases familiarity and local knowledge of a market. Moreover, the small or medium size of most regionally-based firms allows for quick and flexible decision making and substantial headroom for developing economies of scale that can dramatically improve firms' competitiveness and allow them to develop export markets beyond the BSEC Region.

In previous years, the services sector, which accounted for about 63% of GDP formation in 2017, tended to drive overall economic activity and to post growth rates that exceeded those of the national economy. It was the principal driver of economic and employment growth during prosperous years, as it is comprised of many of

5 At the time of publication, breakdown of trade figures by individual country in 2017 were not available for many countries, therefore aggregate BSEC trade data was not available.

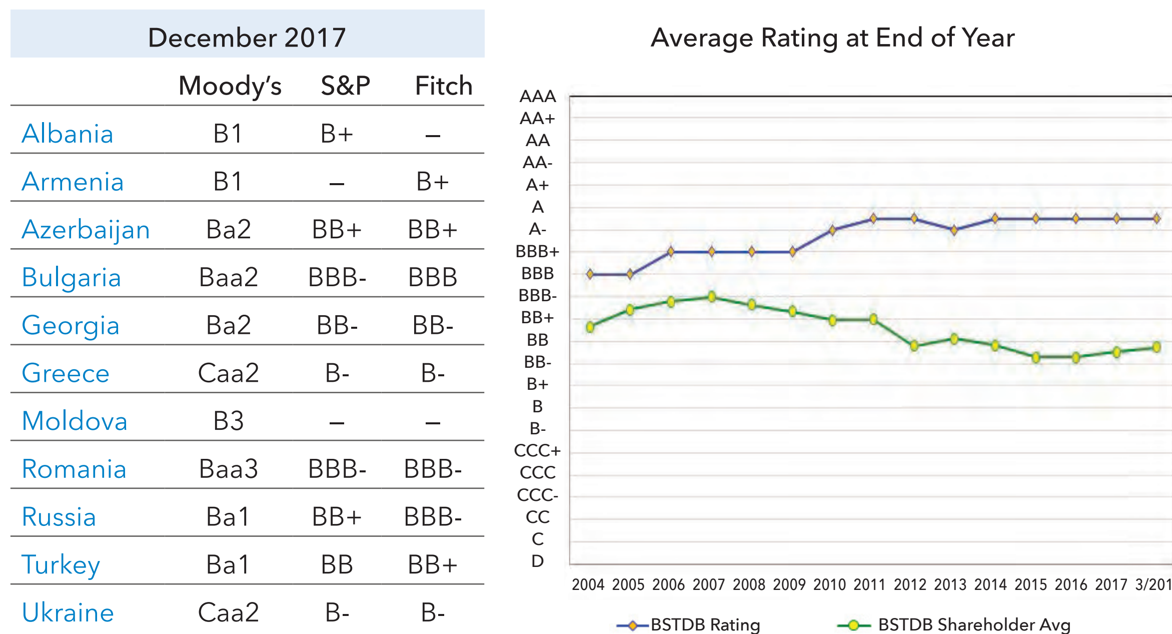
the small- and medium-sized enterprises that have disproportionately accounted for new job creation in the region.

At the other extreme, the agricultural sector has displayed high volatility in an overall context of declining growth. In other words, there are sizeable fluctuations in output from year to year and country to country. However, results have generally lagged behind overall economic activity and thus a shrinking share of GDP formation - slightly less than 6% of GDP formation regionwide - and declining employment levels. Industry, accounting for an estimated 31%, has maintained its share of contribution to the overall economic activity over the years with much lower volatility than agriculture but higher than services. Industrial production has also tended to move in line with international trade patterns, faring better in years with high volumes and prices and vice versa.

An interesting feature of the supply side of GDP formation in the Black Sea Region for 2017 was that production appears to have been quite balanced in terms of sector of origin. The agricultural sector is estimated to have grown by 3.2%, the industrial sector by 4.2%, and the services sector by 3.5%. Such balance was rare in previous years; sectoral outturns differed considerably. Moreover, while exceptions exist, these largely balanced results have, for the most part, applied across the board to the BSEC countries. This may well be a one-off coincidence, particularly since exogenous economic factors affect industry and agriculture, and agriculture is further affected by climatic conditions, but for 2017 it highlights the steady and far-reaching nature of the growth achieved.

While the Black Sea Region has been doing well, both collectively and at individual state level, the problem of weak external perceptions of the region persists. Despite the strong economic performance and the strong underlying fundamentals that imply improved resilience and lower vulnerability to sudden shocks, the region continues to score relatively poorly on measures of risk.

Figure 5: Regional Credit Ratings at End 2017 & Average Evolution Over Time



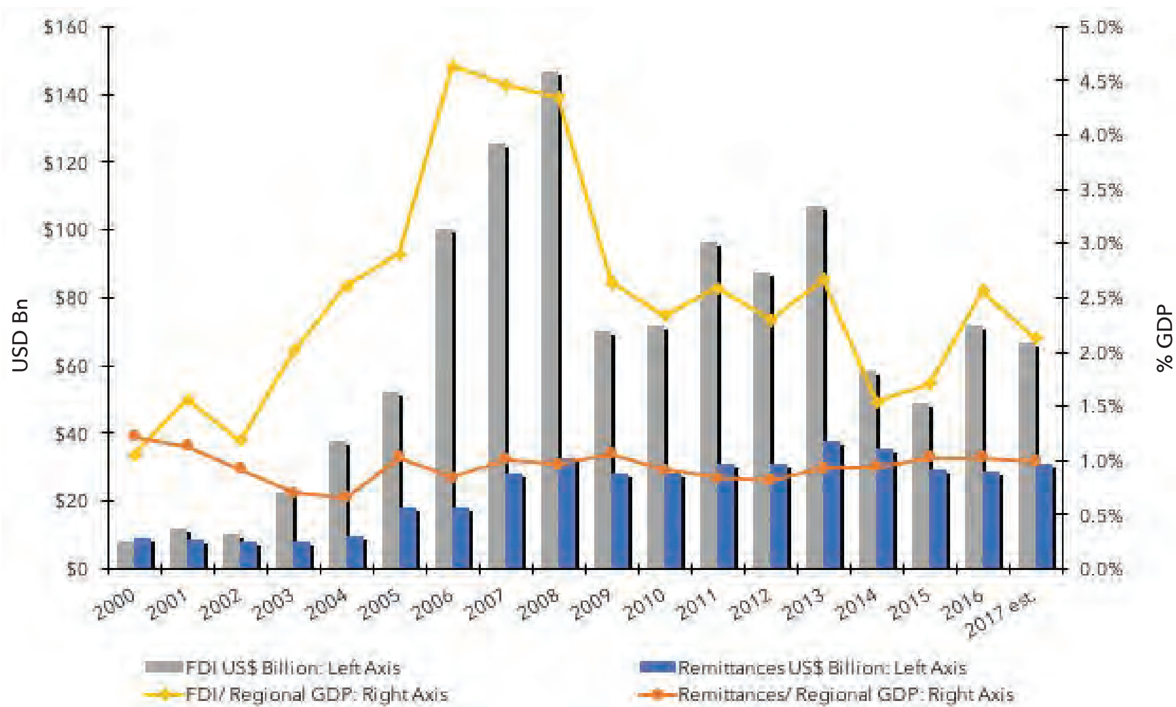
December 2017			
	Moody's	S&P	Fitch
Albania	B1	B+	–
Armenia	B1	–	B+
Azerbaijan	Ba2	BB+	BB+
Bulgaria	Baa2	BBB-	BBB
Georgia	Ba2	BB-	BB-
Greece	Caa2	B-	B-
Moldova	B3	–	–
Romania	Baa3	BBB-	BBB-
Russia	Ba1	BB+	BBB-
Turkey	Ba1	BB	BB+
Ukraine	Caa2	B-	B-

One such example is shown in Figure 5: the left-hand table shows the long-term sovereign credit ratings of BSEC member countries, as adjudged by the three largest credit rating agencies (which account for over 90% of the global market). Depending upon which rating agency one subscribes, the ratings compare poorly with other countries that possess higher per capita incomes, but much higher debt levels and / or current account deficits or other indicators of potential vulnerability. At the end of 2017, only two (or in the case of Fitch, three) BSEC countries qualified as investment grade (a rating of at least BBB minus/ Baa3), while the region's overall weighted average credit rating stood between BB (Ba1) and BB minus (Ba2).

The right-hand chart in Figure 5 shows the evolution of the average weighted credit rating of Black Sea countries since 2004, and compares it to the evolution of the average credit rating of the Black Sea Trade and Development Bank. Whereas the Bank and the regional ratings were within a couple of grades of each other up until end 2008, from the time of the global financial crisis onward, the two have diverged. By end 2017, BSTDB's credit rating (A2 by Moody's / A minus by S&P) was nearly six grades higher than the average weighted credit rating of its shareholders. BSTDB's growth and prudent risk management have resulted in several upgrades over the years as the institution has evolved, including during the post financial crisis period. Unfortunately, for the sovereign states of the Black Sea Region, the ratings treatment has been much more unfavorable. Credit rating agencies have been quick to downgrade during periods of economic downturn, but very slow to upgrade countries even when they return and surpass their pre-crisis levels. This is all the more incomprehensible given the fact that countries undertook difficult measures during the crisis period which, on the one hand, re-stabilized the economies and, on the other, created the basis for the aforementioned healthy macroeconomic figures and reduced vulnerability-level indicators.

In other words, not only did the countries demonstrate resilience and push through difficult reforms when necessary, they have persisted in following prudent policies which have resulted in healthy, if not robust, indicators improved balance, higher reserve levels, and lower exposures to debt and the continued dependence on external financing. Yet this has not translated into improved assessments or more positive depictions of the considerable achievements attained. The lag in outsiders' views has outlasted the downturns and failed to catch up to the upturns.

Figure 6: Foreign Direct Investment & Remittances in the Black Sea Region 2000–2017



Sources: National Statistical Agencies, IMF-IFS, World Bank

The poor perceptions from the outside have negative implications for attracting external financing into the region. Higher perceptions of risk result in foregone investment, trade and financial flows to the detriment of the affected economies. Figure 6 shows one such manifestation – the flow of foreign direct investment (FDI) into the Black Sea Region over the years. It tells a tale of FDI volatility from year to year[6] and an overall declining trend for investment flows from abroad over the course of the 2010s. After two years of steep decline in 2014–2015, there was a turnaround in 2016, as FDI into the region rose to USD 72 billion, equal to 2.6% of regional GDP. However, the estimates for 2017 appear disheartening. Despite the region's robust growth and positive outlook, FDI appears to have declined to around USD 67 billion, a figure equivalent to around 2.1% of regional GDP. It continues to lag behind the levels of GDP attracted by the CEE & Baltics Region (3.4% of GDP in 2016 and 2.7% of GDP in 2017 respectively), and it perpetuates a weakening trend over the course of the last ten years.

With weak investment having been a drag on regional growth for many years, externally financed investment is needed to help sustain the recovery and to improve the region's wealth generating capacity. Moreover, while the region has reformed its financial sectors and made concerted efforts to widen and deepen local financial markets to finance investment, the region's financial markets are still relatively small compared to the financial markets in the wealthy advanced economies of Western Europe. This creates room for catching up and underscores the potential for financial sector development in the Black Sea Region; however, it means that, for now, external financing is needed to achieve higher growth rates and converge towards the high income levels and living standards of the wealthy economies. FDI is one indicator of how much external financing is being attracted to expand the wealth generating potential of an economy, and its sluggishness suggests there is still much room for improvement.

Figure 6 also shows trends in remittances in the Black Sea Region. While remittances are counted in the current account rather than the capital account, they represent the principal source of financing for certain economies with large diaspora or emigrant populations working abroad and sending money home to relatives. As a whole, the level of remittances in the Black Sea Region was slightly less than half the level of FDI attracted. Most notable, however, is remittances' remarkable stability over the years. While other forms of financing fluctuate considerably from year to year, remittances have consistently been measured at around 1.0% of GDP, with very slight variance from year to year. In nominal terms, they have ebbed and flowed with the economic performance of sending countries, and other factors such as exchange rates, but even there the performance has been relatively flat. After declining from a peak of USD 37.5 billion in 2013 to USD 28.8 billion in 2016, they recovered slightly to an estimated USD 31.0 billion in 2017, with smaller-sized economies receiving levels which ranged from around 8% up to nearly 20% of GDP. This underscores remittances' importance in alleviating poverty among parts of the population and for accumulating foreign exchange reserves at national level.

Looking forward to 2018, the Black Sea Region is well placed to continue its current period of growth. As per Figure 1, current projections are for real GDP growth to the order of 3.0% for the year. If the global economy expands at 3.9%, as the IMF projects in its January 2018 update to the World Economic Outlook, then the Black Sea Region is more likely than not to outperform its forecasts. Notwithstanding some country specific trends which could eventually lead to overheating if left unchecked – an unlikely development given most Black Sea countries' demonstrated track record of prudence and willingness to take tough decisions- the region is well placed to sustain and build on the positive outturns of 2017. Given past history, regional projections have usually proven too conservative, as actual growth over the course of a year has tended to outpace the original predictions.

6 Notwithstanding the disappointing FDI flows over the years, other sources of external financing have been even more volatile, such as external lending flows and portfolio investments since they are less tied to fixed assets and can thus reverse and move sharply upon changes in investor sentiment (irrespective of whether it is prudent or panicked).

There are two risk factors in this promising picture, one internal and one external. Internally, while the broad macroeconomic indicators are encouraging and support the expectation of continued growth, the degree to which this progress improves everyday lives and living standards has proven elusive. One big test most societies face will be improving how the fruits of growth are distributed as well as tackling lingering unemployment and poverty. Challenges that have eluded many countries in the post-crisis period, globally as well as in the Black Sea Region, are poverty and unemployment rates that rose sharply during the downturn but have been slow to come back down. There is also a sense among large segments of the population in many countries that the gains from growth are poorly distributed and tend to go to a limited number of privileged groups. This belief risks causing resentment, which invariably affects domestic politics.

Externally, there are a number of issues beyond BSEC countries' control that could slow, or possibly even derail the positive economic expectations. Sudden changes in monetary policy either in the US or the Eurozone could generate currency volatility and turmoil in markets, although the measures to reduce debt, balance external accounts, increase reserves, etc. of BSEC countries have reduced their vulnerability to sharp reversals, especially in the short term. Geopolitical conflicts, such as the continued war in Syria or unforeseen trouble elsewhere, may put a drag on economic activity and worsen perceptions about the region's stability and prospects. Lastly are the equally unpredictable consequences of global trade conflicts, a prospect which appeared prominently in the first quarter of 2018 with the unilateral imposition of tariffs by the United States on steel imports, and the sharp and worried reaction it triggered.

BSTDB in the Black Sea Region

Assessment of Progress – Medium-Term Strategy and Business Plan 2015–2018

A. Overview

By creating the Black Sea Trade and Development Bank (BSTDB, the Bank), BSEC participating states made a clear statement about their commitment to regional cooperation. Amid multiple cooperation initiatives and organizations for Eastern Europe and 'transition countries', only BSEC invested in establishing a financial institution specifically for the region. The Bank's shareholding structure reflects the relative economic strength of its Member States, but the Agreement Establishing the BSTDB has provisions that allow eventual equal ownership of the Bank by its members.

Shareholder support has been demonstrated by the increase of the authorized and subscribed capital of the Bank from an initial SDR 1 billion, to SDR 3 billion authorized and SDR 2 billion subscribed. The SDR 1 billion of unallocated authorized capital is available for potential new shareholders. The functional and reporting currency was changed from SDR to EUR on 1 January 2011.

Since its creation, BSTDB has shown resilience and effectiveness. A 'borrowers' club organization', BSTDB abides by the principle 'unity through diversity'. The Bank has never experienced any problem due to changing political circumstances and has always left aside political and economic disputes, with shareholding Member States giving the necessary administrative autonomy to the management while also providing the necessary support for the Bank to thrive.

The Bank has built and cemented its reputation as a reliable partner in development and as a promoter of cooperation in the Black Sea Region. As a consequence, BSTDB is the best rated entity in the region, assigned ratings of A2 by Moody's, and A- by Standard and Poor's.

What makes the BSTDB special is its crucial role as a financial pillar of cooperation in the Black Sea Region. This role has become even more important in the aftermath of the worst global financial crisis since the end of WWII.

The global crisis has created a climate of volatility and uncertainty, to which BSTDB adapted successfully by adopting strategies which, first and foremost, preserved asset quality and allowed it to react quickly and flexibly to rapidly changing market conditions. The Bank aimed to diversify its sectoral exposure (private sector, financial sector, public sector, sovereign backed projects) and to balance its exposure to the Member States. Furthermore, the credit crunch triggered by the financial crisis demanded more effort and resource to secure financing in a global market with greater risk-aversion, but again the Bank proved to be successful. The Bank was able to safeguard its interests while fulfilling its mandate.

Supervising existing bank operations took on additional importance in view of the stresses experienced by both companies and financial institutions as a result of the financial crisis. In practice, this meant increased attention to ensuring quality at entry and a shift towards more public sector or quasi-public sector operations. The Bank also put greater emphasis on real-economy sectors such as energy, infrastructure, transport, public utilities and telecommunications, reducing the share of its exposure to the financial sector.

B. Strategic Objectives and Goals

Long-Term Strategic Objectives

As presented in the Long-Term Strategic Framework (LTSF) approved by the Board of Governors in 2009, the Bank intends to continue and expand its activities and devise new ways to increase the efficiency of its development assistance, while extending cooperation with other partners in development.

The LTSF envisioned under a 'maintaining the trend scenario' growth of the outstanding portfolio to around EUR 1.7 billion by end 2018. However, due to the severity of the 2008 global crisis and the persistent risks and uncertainties, the target for the outstanding portfolio was adjusted down to a more realistically achievable figure of between EUR 1.5 and EUR 1.6 billion at end 2020.

Medium-Term Strategic Goals

Under the MTSBP 2015–2018, the Bank expected to increase its portfolio of outstanding operations to EUR 1,320 million under the High Case Scenario, which, given improvement in the Member States' economic prospects, became the targeted Base Case Scenario under the updated Mid-Term Strategy.

However, given prevailing global and regional uncertainties, such an objective needs to be tempered by flexibility and adaptability to changing conditions. The uncertainties which may affect the Bank's ability to achieve its goals include both exogenous factors such as interest rate and monetary policy volatility, commodity price fluctuations, events of a non-economic nature, and endogenous factors such as those induced by exchange rate stresses.

Therefore, given that risks are tilted to the downside, the priorities outlined in the MTSBP remain relevant for the institution, and they will guide the remaining period of implementation up through 2018. Such an approach would respond appropriately to the continuing external challenges while also satisfying internal constraints.

C. Medium-Term Strategy Progress 2015–2017

Overall progress assessment

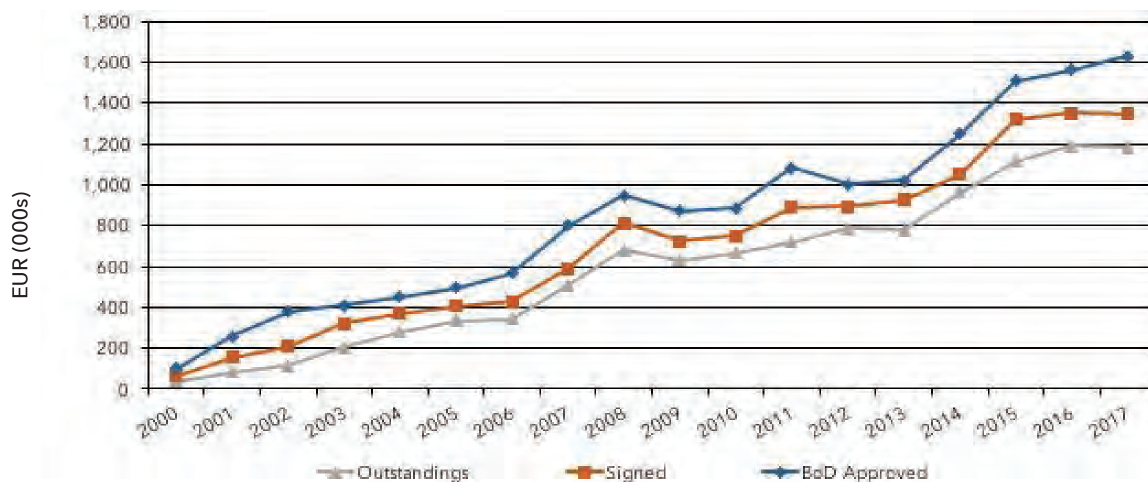
The Bank has always sought to be flexible and ready to adapt to changing conditions. Despite facing conditions of considerable adversity and uncertainty, the Bank has developed a high quality portfolio and has maintained profitability.

Operationally, the Bank prioritizes:

- Increasing direct financing to 'real' sectors of the economy;
- Continuing efforts to become more involved in public sector projects;
- Limiting exposure 'risk' to financial institutions;
- Improving the balance of activities across countries;
- Working out and ultimately maintaining a low level of NPLs.

Since the start of operations in 1999, the Bank has steadily grown its business generation activities:

Figure 1: Development of Active Portfolio Net of Repayments 2000–2017



Source: BSTDB

Operationally, compared to 2014, the Bank made progress by most measurements and business activity in most countries is ahead of target:

Table 1: BSTDB Performance 2015-2017

€ Million	2015	2016	2017	2015–2017	2015–2018
	(a)	(b)	(c)	(a)+(b)+(c)	
Annual target BoD approvals	304.0	326.0	376.0	1,006.0	1,410.0
Actual BoD approvals	487.2	433.3	524.6	1,445.1	
Percent target met	160.3%	132.9%	139.5%	143.7%	102.5%
Annual target for signings	266.0	286.0	329.0	881.0	1,234.0
Actual signings	480.3	373.2	400.7	1,254.2	
Percent target met	180.6%	130.5%	121.8%	142.4%	101.6%
Annual target for disbursement	296.0	309.0	296.0	901.0	1,200.0
Actual disbursement	378.8	454.5	393.8	1,227.0	
Percent target met	128.0%	147.1%	133.0%	136.2%	102.3%
Annual target for repayments	180.0	231.0	233.0	644.0	892.0
Actual repayments	221.7	383.1	316.3	921.0	
Percent target met	123.2%	165.8%	135.7%	143.0%	103.3%
BP target for outstanding	1,056.0	1,200.0	1,280.0	-	1,350.0
Actual outstanding	1,113.4	1,191.8	1,166.4	-	
Percent relative to BP target	105.4%	99.3%	91.1%		86.6%

Source: National Statistical Agencies, World Bank & IMF-IFS

The Bank made good progress towards achieving the goals established under the MTSBP 2015–2018. Some of the targets are already met, even exceeded, while for the outstanding amount is achievable by end 2018. We also made good progress towards goals, such as the share of public and quasi-public sector operations, and achievements are above the target in other areas such as the share of overall exposure to smaller shareholding countries.

The share of public sector operations increased, with commitments showing a gradual advance towards meeting the MTSBP goal:

SIGNED		
	End 2016	End 2017
MTSBP Target for Public Sector: 20%		
Public	10.2%	16.6%
Sovereign	7.3%	13.5%
Non-Sovereign	2.9%	3.0%
Private	89.8%	83.4%

The Herfindahl-Hirschman Index (HHI) for country concentration at end 2017 shows a significant improvement, exceeding the 1400 goal laid out in the MTSBP and relative to the 1461 level at end 2014. In fact, the current level of 1320 is the highest, for country diversification, reached by the Bank in recent times.

The Bank has also made tremendous progress in reducing sector concentration. The HHI for sector concentration declined to 1888 from 3137 at end 2014. In addition to reducing the share of financial institutions, the share of trade finance in intermediated operations has grown substantially, as has the share of public sector operations.

- Country concentration @ 1320 / below 1400 target
- Sector concentration @ 1888 / mainly due to reduction of FI operations to 35.9%

Figure 2: BSTDB Herfindahl-Hirschman Index (HHI) for Country and Sector Concentration 2004–2017

Source: BSTDB

To develop further an institutional culture of transparency, communication, cooperation and sound corporate governance, the Bank developed a performance management system to support the achievement of its key goals by end 2018.

Generally speaking, on everything that was under our control we performed as planned or better. Overall, operationally, 2015–2017 was a very good period for the Bank.

Financially, we also had a very good performance.

In 2016, we successfully launched and finalized our first benchmark bond issue of USD 500 million. Although market conditions overall were not completely favorable, the Bank took advantage of noticeable improvements and succeeded in maintaining a reasonably sound portfolio. However, the crisis took its toll and we did have to make higher than anticipated provisions to make some write-offs, and to reduce the value of some of our equity investments.

At end 2017, three operations were classified as non-performing, with the non-performing loans (NPL) ratio as a share of the loan portfolio outstanding balance at an estimated 2.14%.

	End 2014	End 2015	End 2016	End 2017
Maximum Tolerable Level of NPLs:		5.00%		
NPLs as Share of Loan Portfolio	5.52%	1.24%	3.44%	2.14%

Nevertheless, the Bank is well protected, with the cushion of provisions, reserves and surpluses reassuringly above the amount at risk in problem exposures. Notwithstanding this additional 'cost', we estimate that over the medium-term, the Bank will make a net cumulative profit which will be in line with the MTSBP target.

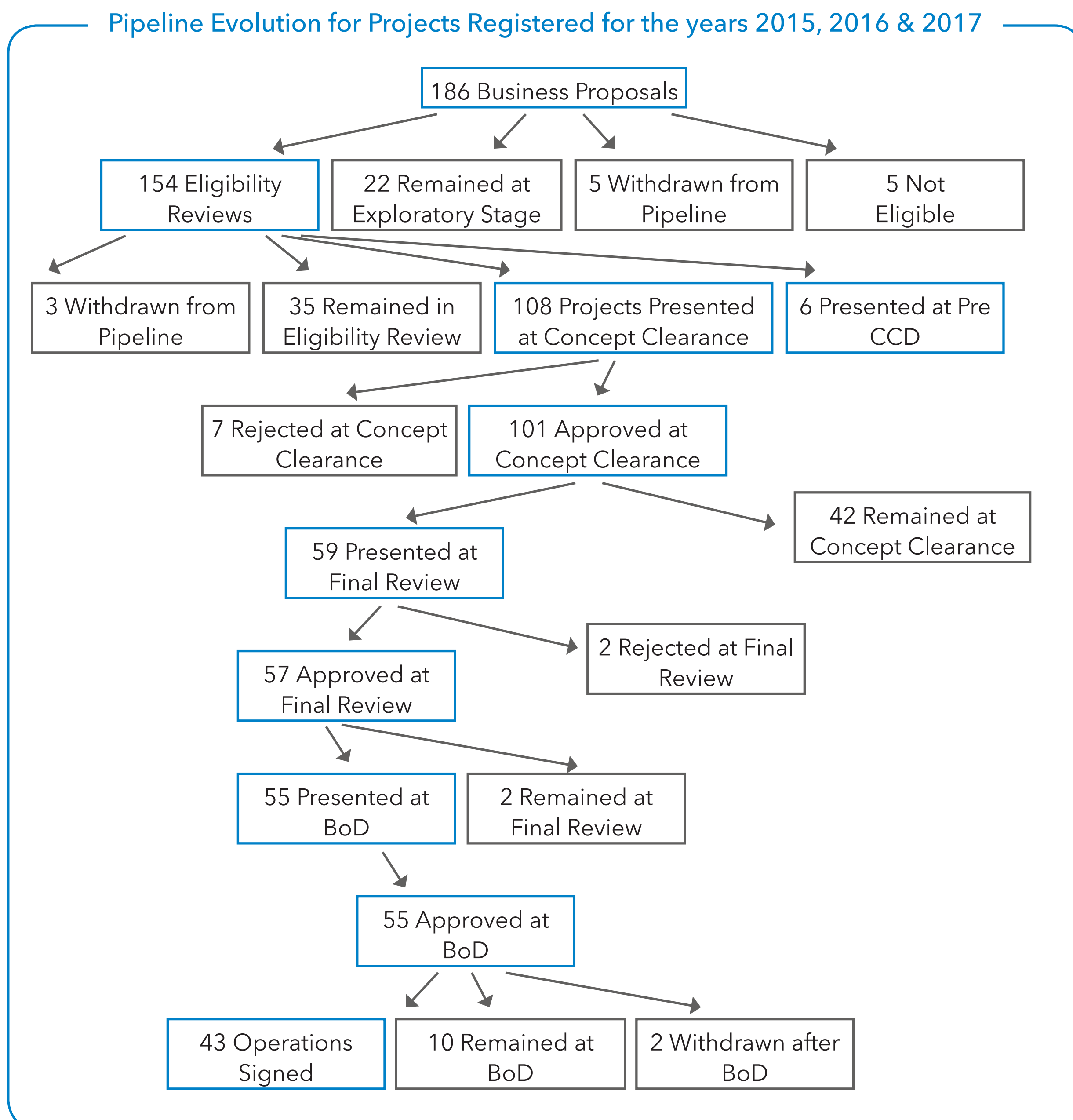
Also, BSTDB decided to prepare itself ahead of time and implement as soon as feasible the new IFRS 9 standard, to which end upgraded existing, and adopted new, relevant policies and regulations.

D. Developments during 2015–2018

The Bank's performance over the MTSBP up to end 2017 was excellent. Resources were allocated to maintaining the portfolio quality and to expanding activity with efforts equally devoted to monitoring and supervision, while the Bank acted proactively and restructured a number of operations before they could turn problematic.

Throughout the period, a highly intensive and selective business development effort resulted in identifying 55 new operations that were presented to the Board of Directors (BoD) for approval, from a total of 186 business proposals of which 101 were approved at Concept Clearance by the Credit Committee. Of these, 43 operations were signed, for a total amount of slightly over EUR 782 million. There are 44 new business proposals to still be considered for Final Review by the Credit Committee, of which those that are sustainable and have the desired development and cooperation impact are expected to be presented to the BoD for approval in the coming months. The actual number of operations approved by the BoD over the period 2015–2017 was larger than 55, as it included operations identified before 2015.

The following graph depicts the developments that took place cumulatively over the first three years of the current MTSBP 2015–2018:



As further proof of the Bank's commitment to achieving the MTSBP targets, business generation and operational activity accelerated during the first quarter of 2018, and resulted in 5 new operations, denominated both in international and local currencies, signed for total amounts of EUR 46.4 million, USD 72.5 million, and GEL 75 million. In addition, the Board of Directors approved three new operations, expected to be signed shortly, for total amounts of EUR 40 million and USD 32 million. Further acceleration is estimated for the second quarter and a similar performance is anticipated for the second semester of 2018.

E. Promotional Activities

During the first three years of the period covered by the MTSBP 2015–2018, the Bank made significant progress towards increasing awareness of its activities in the region. In particular, through targeted business presentations in member countries, concluding memoranda of understanding with partners in development, and the newly-established corporate presence on social media.

Year End \ Activity	Social Media Accounts Twitter, Facebook, LinkedIn (total number of followers)	Signed MoUs	Business presentations
2015	5,750	1	2
2016	8,950	7	4
2017	13,230	5	3

In 2015, corporate accounts were opened on the Twitter, Facebook and LinkedIn platforms, allowing the Bank to access substantially greater regional and global audiences.

In addition, the Bank made nine presentations for business communities in eight member countries over the period.

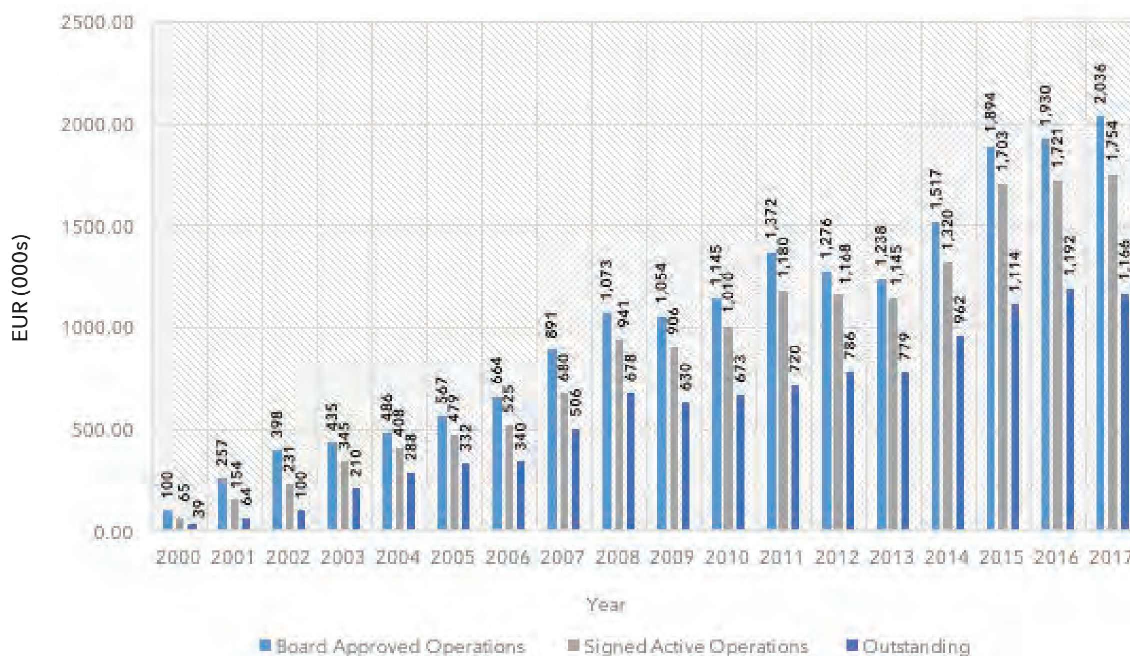
Furthermore, the Bank signed 13 new memorandums of understanding with a number of national, regional, as well as non-regional partner development institutions and business associations:

- 2015 - Union of Chambers of Commodities of Turkey;
- 2016 - Bulgarian Development Bank, Foreign Investors Association of Albania, Bank of China, Islamic Corporation for the Development of the Private Sector, European Investment Fund, Federation of Industries of Northern Greece, Dagong Ratings (China);
- 2017 - Black Sea Project Promotion Facility, Global Infrastructure Hub, Russian Federal Corporation for Small- and Medium-Sized Entrepreneurship, National Bank of Moldova, Chambers of Commerce and Industry of Moldova and Ukraine.

Portfolio Description

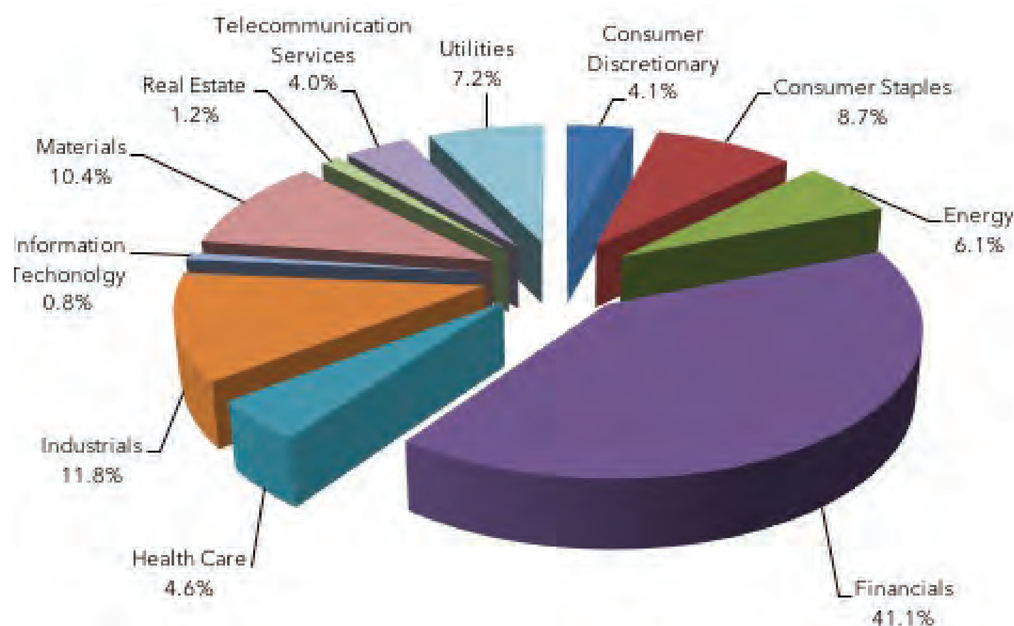
Since beginning of operations in June 1999, the Bank has approved 365 operations amounting to about EUR 4.9 billion. Throughout this period, there were 313 signed operations for a total signing amount of EUR 4 billion. A total of 262 operations for about EUR 3 billion were repaid. At end 2017, there were 109 operations in the total portfolio outstanding balance for EUR 1.17 billion.

BSTDB Portfolio Development from 2000-2017



Source: BSTDB

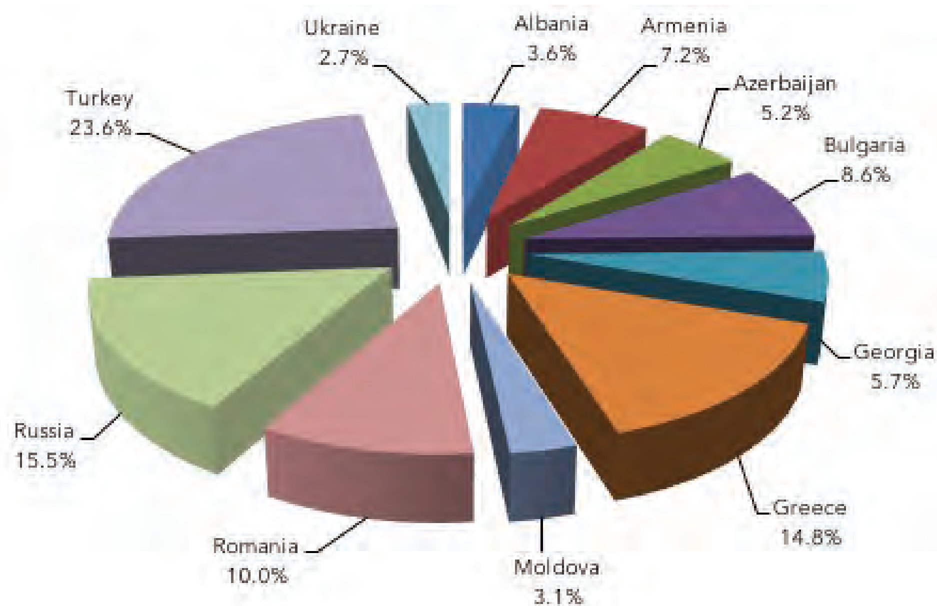
Cumulative Signed Operations by Sector



Source: BSTDB

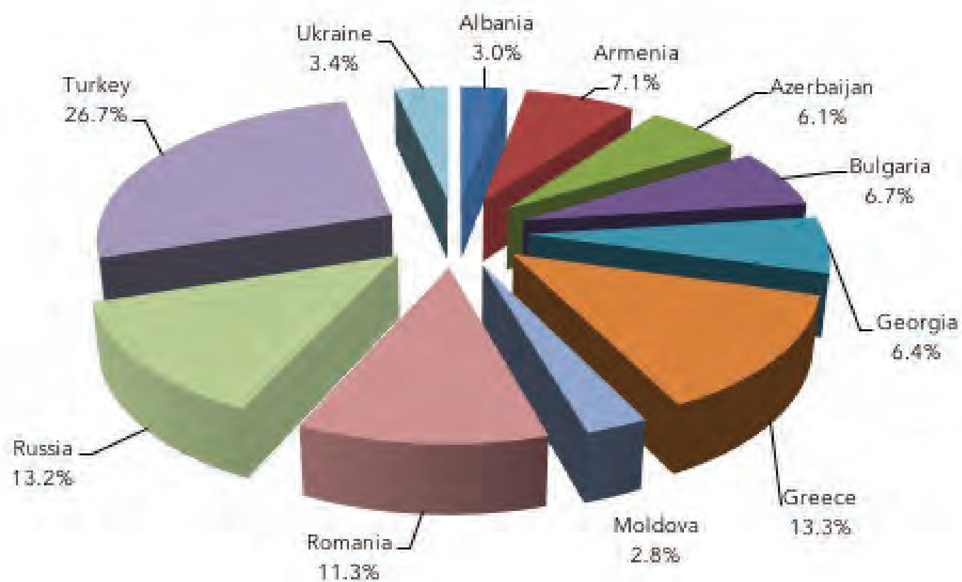
As of end 2017 the outstanding operations of the Bank (cumulative disbursements less repayments for active operations) represented EUR 1.17 billion, distributed by country as per the following graph:

Outstanding Operations by Country



Source: BSTDB

Active Signed Operations by Country



Source: BSTDB

2017 Portfolio Developments

In 2017, the Board of Directors approved 26 new operations for a total of EUR 525 million. Nineteen new operations were signed for a total of EUR 401 million. As a result, the Bank had 109 outstanding operations to 89 clients at the end of 2017.

Portfolio structure by sector remained broadly in line with the Bank's historical trends. As in previous years, the most significant exposures were in financial institutions, industrials materials, utilities, consumer staples and energy. Significant exposure to financial institutions reflects BSTDB's strategic focus on the SME sector development, trade finance, leasing and mortgage lines of credit extended through financial intermediaries in member countries. The Bank's participation in regional SME equity funds represented a further 2.6% of the outstanding portfolio.

Enhanced effort was put into increasing the share of the real (i.e. non-financial) sector, which reached 64.3% of outstanding portfolio at year-end. Two thirds of the new approvals in 2017 went to the real sector. The sectorial structure was well diversified, with projects originating from various industry and economy sectors: manufacturing, agribusiness, healthcare, energy, IT, financing small and medium enterprises, leasing, trade finance, etc.

Co-Financing

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

In the course of 2017, 57.3% of signed portfolio was co-financing. In terms of total signed active portfolio in the amount of EUR 1.8 billion, 52.8% of operations are co-financing. The share of co-financed active operations to total portfolio outstanding balance is 54.2%.

In 2017, the Bank co-financed the following operations:

1. Fraport Operation Greece with EUR 62.5 million for a total amount of EUR 1.6 billion with Alpha Bank EBRD, IFC, EIB & Equity.
2. Hellenic Petroleum Finance Greece with EUR 50 million for a total amount of EUR 312.9 million with EBRD & other financing sources.
3. Trans-Oil Pre Export Finance Moldova with USD 30 million for a total amount of USD 170 million with FIMBank plc, Arab Bank Ltd (Switzerland), Banque Cantonale Vaudoise, Nederlandse Financicrings-Maatschappij, Societe Generale Paris & Unicredit Bank Austria AG.
4. Energo Pro Eurobond Bulgaria & Georgia with EUR 42 million for a total amount of EUR 370 million with other financing sources.
5. CCN Medical Research Center Turkey with EUR 50 million (EUR 30 million A loan direct financing & EUR 20 million B loan from the OPEC Fund) for a total amount of EUR 711 million with EBRD, Islamic Development Bank, Oesterreichische Entwicklungsbank AG, ECO Trade and Development Bank, Islamic Corporation for the Development of the Private Sector, Finansbank A.Ş, Ankara Branch, OPEC Fund for International Development & other financing sources.

Highlights of BSTDB banking activities during 2015–2017

During the implementation period of the MTSBP for 2015–2018, the Bank's portfolio has been increasing at an average annual rate of 6.7 %, close to the base case scenario in the MTSBP, while portfolio quality has been maintained. The portfolio structure has become the most balanced in the Bank's recent history, both in terms of geographical distribution and sector breakdown.

Increased attention has been paid to the countries considered underrepresented in the Bank's portfolio. As a result, the Bank has been able to fulfill its mandate in a more balanced way across all member countries. At the end of 2017, the HHI for country concentration was already well below the 1400 target set in the MTSBP for end 2018.

After an extended period of somewhat high-percentage exposure to financial institutions, the Bank set as a strategic target an increase in the share of real sector operations in its portfolio. The MTSBP targeted the share of transactions intermediated through financial institutions to decrease to 45% of the portfolio by the end of the Strategy period. In fact, by end 2017 the Bank had already reduced financial institutions' exposure to 36% of the portfolio, a level well below the MTSBP target figure. The Bank's increased direct lending to real sector companies reflects one of BSTDB's distinctive qualities: the ability to effectively address the financing needs of medium and even rather small enterprises not only through financial intermediaries, but also by accessing them directly. Noteworthy as well is the diverse portfolio breakdown among industries in the real sector, no single sector accounting for more than a 14% share in the Bank's outstanding portfolio at end 2017.

Implementing country strategies has remained the focus for the Bank's operations. Currently, the implementation of eight out of eleven country strategies has been rated internally as good or excellent, compared to five in the previous strategic planning period.

The Bank has maintained its focus on achieving the institutional Key Performance Indicator of mandate fulfillment. The share of post evaluated operations rated positively on overall performance has remained acceptably high, exceeding the minimum 70% target set in the MTSBP for end-2018.

The MTSBP set a 15–20% share of public sector operations in Bank's portfolio as a strategic goal for end 2018. As of end 2017, the Bank is close to achieving the target, with the public sector operations share of the portfolio already in double digits.

In line with the Strategy, new financial products have been introduced, aiming to meet the growing sophistication in the regional market and evolving client needs, including:

- Local currency lending: since 2015, the Bank has been successful in providing local currency lending in four of its member countries, namely Armenia, Georgia, Romania and Russia. Funding for these operations has come from either derivative market transactions or bond issuance. In Armenia, a debut AMD 2 billion issue was the first public offering of BSTDB's bonds in a member country;
- Pre-export finance: the Bank developed pre-export finance support mostly, though not exclusively, for the agriculture sector via direct lending to sustainable exporters in several member countries where agriculture holds a significant share in GDP;
- Purpose-related bonds: the Bank provided anchor investor support for clients' bond issuances dedicated to funding specified capital investment programs;
- Reserves-based lending: the newest financial product introduced by the Bank is reserves-based lending, specifically suitable to finance capital expenditures of companies operating in the extractive industry;
- Participation in PPPs: in line with its development mandate, the Bank has significantly expanded its engagement alongside fellow IFIs and commercial lenders in high-profile projects implemented through public-private partnerships (PPPs) in priority sectors, such as healthcare (hospitals, research center) and transport infrastructure;
- Co-financing: special attention has been given to co-financing with other development banks and to parallel and joint financing with commercial banks, so the Bank can 'leverage' its obligor limit. The Bank has particularly cultivated co-financing opportunities with the institutions holding BSTDB Observer Status. The ratio of operations co-financed alongside other development banks in the Bank's portfolio now exceeds 40%, the highest percentage in the Bank's history;
- A/B loans: the Bank is now not only formally arranging co-financings through provision of parallel loans, but has started extending A/B loans to mobilize other financial institutions' financial resources.

Technical Assistance Support

Development Bank of Austria Fund

The Bank administers a Technical Cooperation Special Fund (the 'Fund'), established in 2008 with the Development Bank of Austria (OeEB). OeEB contributed to the Fund an initial amount of EUR 500,000 provided by the Government of Austria as Official Development Assistance (ODA). The Fund is an untied facility offering financing for a wide range of technical assistance services related to project preparation and training needs of BSTDB clients in the eligible countries of the Black Sea Region. The Fund represents the first financial facility of this kind, given to BSTDB by an institution not based in the BSTDB countries of operation. It can be used for assignments in the BSTDB member countries that are eligible to receive ODA.

In 2017, the Fund co-financed a due diligence assignment to appraise a project in Moldova. The cost of the assignment was financed 65% by the Fund and 35% by the appraised company.

Since its establishment, the Fund has disbursed EUR 415,912, mainly for project preparation assignments.

Hellenic Fund

The Bank administers a special fund (the 'Hellenic Fund') established in 2001 by a Contribution Agreement between the Government of the Hellenic Republic and BSTDB. The Hellenic Fund was set up with an initial amount of EUR 800,000 and was replenished in 2003 with the amount of EUR 500,000. This was the Bank's first special fund responding to the need for higher quality project-related information provided by prospective clients.

The Hellenic Fund is tied to consulting companies in Greece. However, up to 25% of an assignment cost may be allocated to consultants who are nationals of the other member countries.

Since its inception, the Hellenic Fund disbursed around EUR 1.3 million for 40 consulting assignments. The companies benefitting from these funds operate in manufacturing, telecommunications, oil and gas, transportation, agribusiness, renewable energy, tourism, real estate, retail and banking. The Hellenic Fund has been used for consultancy services in nine BSTDB member countries: Albania, Armenia, Bulgaria, Georgia, Greece, Moldova, Romania, Russia and Ukraine.

Black Sea Project Promotion Facility

Aiming to improve investment access for SMEs in the Black Sea Region, the Russian Federation initiated the establishment of the Black Sea Project Promotion Facility ('BSPPF'), funding it by an initial contribution of USD 1 million. BSPPF targets the finance technical assistance services for preparing feasibility studies, business plans, due diligence analysis, creating networks or partnerships for activities mostly related to energy efficiency and renewables, environmentally friendly technologies, infrastructure, trade exchanges, and knowledge-sharing. Financing requests may be brought by BSTDB and the Permanent International Secretariat of the Organization of the Black Sea Economic Cooperation (the 'BSEC PERMIS').

The BSPPF statutory documents were adopted in 2017. A steering committee has been established to review and approve the allocation of funds. BSPPF is focusing on pilot medium-sized projects meeting the established criteria and requirements of BSEC PERMIS and BSTDB. In September 2017, BSPPF funded the first assignment submitted by BSTDB for a consultant to undertake the environmental and social due diligence for a pulp and paper producer.

Selected BSTDB Financings in 2017

Modernization of 14 Regional Airports in Greece

The Black Sea Trade and Development Bank joined forces with Alpha Bank (Greece), EBRD, EIB and IFC to provide long-term project financing of EUR 1.6 billion to Fraport Greece, a consortium of Fraport AG Frankfurt Airport Services Worldwide and a leading Greek industrial conglomerate Copelouzos Group, for the modernization of 14 regional airports, including Aktion, Chania (Crete), Kavala, Kefalonia, Kerkyra (Corfu), Kos, Mitilini, Mykonos, Rhodes, Samos, Santorini, Skiathos, Thessaloniki (Greece's second largest city) and Zakynthos. Combined, these airports served a total of about 25.2 million passengers in 2016.

With BSTDB's lending in excess of EUR 62.5 million for the term of 17 years, the Project represents the largest investment BSTDB has made in Member Countries to date.

Selected BSTDB Financings in 2017

Novotech Terminal (Ukraine)

During the last several years, Ukraine has significantly strengthened its position among the world's leading exporters of grain. Maritime transport is a major channel for transshipment of agricultural produce and has generated new requirements for the development of Ukraine's seaport infrastructure.

The Bank extended a USD 5 million long-term loan to Novotech-Terminal LLC, a private Ukrainian company operating three berths in the Odessa Marine Trade Port. Since 2016, the Borrower has been investing in the expansion of its grain terminal with the view to increasing its throughput capacity up to 2.5 million metric tons per annum. The Bank's funds financed part of the expansion program.

The operation contributed to achieving two major priorities of the BSTDB country strategy for Ukraine, namely promoting export of goods and services and developing infrastructure.

Selected BSTDB Financings in 2017

Trans-Oil Pre-Export Finance Facility (Moldova)

The Bank contributed USD 30 million to a Pre-Export Finance Facility to Trans-Oil Group, a leading agricultural commodities trader and sunflower oil producer in Moldova, as part of a USD 170 million syndicated loan arranged by Société Générale, Zurich Branch.

The proceeds of the loan were used to finance Trans Oil Group's seasonal working-capital needs associated with origination, primary processing, storage and transportation of agricultural commodities sourced in Moldova, and their subsequent export to other countries.

Trans-Oil Group, established in 1996, is a market leader in the origination and trading of grains and oilseeds in the Black Sea Region. The company has developed into a group with an impressive global network of clients, specifically focusing on the regions of Europe, Southern Mediterranean, Turkey, and North/West Africa.

The importance of this operation for BSTDB as a regional development institution stems from its multiple development impact on growth, exports and employment, and from the strategic position of the agricultural sector for Moldova. The Operation corresponds to the priorities set in the BSTDB Country Strategy for Moldova, by supporting a leading private Moldovan group in expanding exports of agricultural produce.

Selected BSTDB Financings in 2017

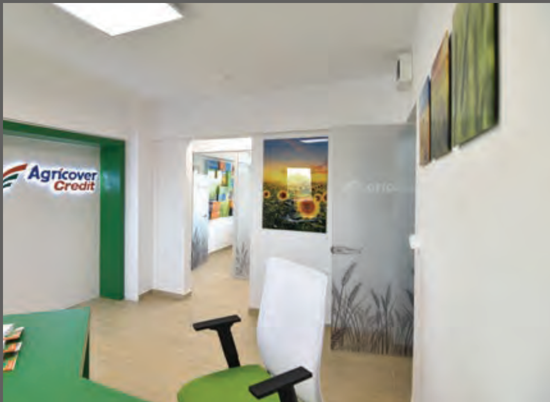
CCN Medical Center (Turkey)

The BSTDB arranged a EUR 50 million A/B loan financing under a EUR 711 million Public-Private Partnership (PPP) project implemented by CCN Laboratuvar Hizmetleri ve Yönetim Anonim Şirketi, Turkey ('CCN Laboratuvar') to finance the design, construction, operation, and maintenance of a Medical Research Center in Ankara. CCN Laboratuvar is a special purpose company created by the CCN Yatırım Holding Anonim Şirketi ('Sponsor') to implement the project.

The Medical Research Center is the first of its kind in Turkey, supporting research activities and providing access to high-tech laboratories. The center will comprise biosafety-level laboratories and research units, the offices of the Turkish Public Health Agency and the Turkish Pharmaceutical and Medical Devices Agency's, social and technical facilities. CCN Laboratuvar, the company established by CCN Yatırım Holding Anonim Şirketi for the project, has been awarded an 18-year concession by Turkey's Ministry of Health to design, construct, operate and maintain the Medical Research Center and provide certain non-clinical services. CCN Laboratuvar will supply and maintain the four research laboratories, while the research services will be provided by the Ministry of Health.

BSTDB acted as Arranger of the 15-year debt financing mandated by the Sponsor, together with the European Bank for Reconstruction and Development (EBRD) and the Islamic Development Bank (IDB). Apart from providing a direct EUR 30 million A-loan facility, BSTDB arranged for a EUR 20 million B-loan from the OPEC Fund for International Development (OFID) and for parallel loans provided by the Austrian Development Bank (EUR 30 million) and the ECO Trade and Development Bank (EUR 15 million).

Selected BSTDB Financings in 2017



Agricover (Romania)

The BSTDB provided RON 69,502,500 (EUR 15 million equivalent) to Agricover Credit IFN, a Romanian financial institution specializing in financing the agricultural sector. This is the Bank's first local currency loan to a Romanian company. The BSTDB financing helps Romanian farmers get access to much-needed local currency funding to improve productivity, generate value added, and create jobs. The new loan builds on the successful cooperation between BSTDB and Agricover Group started in 2013.

Agricover Credit IFN (IFN) - the financing arm of Agricover Group – is the first financial institution in Romania to offer financial products exclusively to farmers in the vegetal and livestock sectors. Its solid knowledge and deep understanding of the farming activity enable the company to develop innovative products dedicated to financing working capital and investments in a flexible manner, customized to the real needs of farmers.

Selected BSTDB Financings in 2017

National Mortgage Company (Armenia)

In response to the growing demand for local currency financing in Armenia, BSTDB provided AMD 2 billion loan to the National Mortgage Company (NMC) to support the development of the mortgage market in Armenia. The BSTDB loan was funded by Bank's debut public placement of a local currency bond. The operation will help Armenian people to access quality housing and will contribute to improved living conditions in the country. The structure of the deal also supports the development of the capital market in Armenia.

This transaction, comprising a local currency loan and a bond, with fully matching parameters and synchronized in time mitigate currency and interest rate risks, was unique for BSTDB, not only for being an inaugural local currency loan in Armenia, but also a debut issue of a bond in Armenia and the first public offering of a BSTDB corporate bond in a member country.

The National Mortgage Company (NMC) is a full subsidiary of Central Bank of Armenia. Its mission is to provide liquidity, stability and affordability to the mortgage market in Armenia. NMC provides long-term funds to financial institutions engaged in mortgage financing to individuals, and integrates housing refinancing and capital markets by means of financial instruments.

Selected BSTDB Financings in 2017

Center-invest Bank (Russia)

In 2017, the Bank provided its first Ruble-denominated loan, amounting to RUB 1 billion, to Center-Invest Bank, based in Rostov-on-Don and operating in Southern Russia, a priority region for BSTDB in the country. This facility responds to the increasing demand from private small- and medium-sized enterprises (SMEs) in Russia for local currency financing. The operation facilitates the access of Russian SMEs to affordable financing, thus stimulating entrepreneurship and economic growth in Southern Russia. 29 eligible SMEs were financed by Center-Invest Bank using BSTDB funds in 2017.

Center-Invest Bank has been a long-standing partner of BSTDB since 2006, when BSTDB provided a subordinated loan of USD 10 million to support the bank's capitalization. In 2014, a second loan, amounting to USD 20 million for SME finance, was extended by BSTDB. The funding was on-lent by Center-Invest Bank to about 90 SMEs to support their business activities in Southern Russia.

Addressing Sustainability

The BSTDB approach

BSTDB addresses sustainability through the operations it finances, and the environmental and social sustainability principles have been duly integrated in the Bank's operation cycle. Thus, respect for fundamental human rights in the working environment; pollution prevention and mitigation; addressing climate change; promoting efficient use of natural resources; protection and conservation of biodiversity; disclosure of information on environmental and social performance of its operations; and engagement in open dialogue with stakeholders, are all part of this approach and together form the core of BSTDB's due diligence practice.

Environmental and Social Due Diligence

All operations considered by the Bank for financing are categorized into A, B+, B, C and FI categories, depending on 1) the associated potential environmental and social risks and impacts, and 2) the scope of the environmental and social assessment necessary to identify, assess and mitigate these risks and impacts.

The due diligence of operations financed directly by BSTDB, depending on relevance in each specific case, focuses on such issues as the environmental and social management applied by the Borrowers; labor and working conditions and how people are treated in the working environment; the applied pollution prevention and abatement measures and how efficient the resources are being used; potential risks on the local communities, their health, safety and security; issues related to land acquisition, involuntary resettlement and economic displacement; impacts on biodiversity, ecosystem services and sustainable use of living natural resources; protection of any cultural heritage; and potential risks and impacts on indigenous peoples if present in the operation's area of influence.

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

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

BSTDB's applied standards and compliance requirements

BSTDB seeks to apply good international environmental and social practices in all the operations it finances. By good practices, the Bank recognizes the performance standards and requirements of the leading Multilateral Development Banks (MDBs), development Agencies, the European Union (EU) E&S standards, the ILO CLS, the World Health Organization (WHO) standards, relevant IMO conventions, as well as relevant international conventions, such as Convention on the Protection of the Black Sea Against Pollution, and the multilateral environmental agreements under the United Nations Economic Commission for Europe (UNECE), in particular the Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters (Aarhus Convention), and Convention on Environmental Impact Assessment in a Trans-boundary Context (Espoo Convention).

All operations considered by BSTDB need to comply with the following minimal E&S requirements: 1) National and applicable EU environmental, labor, health and safety, and public information laws and regulations, including national commitments under international law; 2) Availability of permits, approvals, licenses and certificates required under relevant laws and regulations; 3) Category A operations need to meet the requirements applied by EU, namely the Environmental Impact Assessment (EIA) Directive and relevant sector-specific and cross-cutting Directives, or the requirements applied by WB/IFC. Category A operations that are likely

to generate trans-boundary impacts need to meet the requirements stipulated under the Espoo and Aarhus Conventions irrespective whether the country of operation is a party to the Convention; and 4) Meet the requirements of the BSTDB Environmental and Social Exclusion List.

Public information and consultation

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

BSTDB also discloses to the general and/or interested public, relevant environmental and social information of its Category A operations. For private sector operations this information is disclosed not later than 30 calendar days before the Board of Directors meeting, and 60 calendar days for public sector operations. This information is disclosed on the Bank's website and is open for public comments.

Monitoring and institutional aspects

All the operations financed by the Bank are monitored against the agreed environmental and social compliance requirements to ensure that relevant terms and conditions stipulated in the legal agreement are met. In addition, monitoring helps the Bank to determine whether the prevention and mitigation measures employed in managing the environmental and social risks and impacts are effective or need adjustment.

All aspects of environmental and social sustainability of the Bank are led by the Environmental and Social Sustainability Office, which is charge for developing and implementing relevant strategic objectives, policy statements, and internal procedures. It leads the independent environmental and social due diligence process of operations and advises the Senior Management on the relevant risks and impacts of the financing decision-making, and the general E&S performance of the Bank. It thus ensures the Bank's activities do not affect the state of environment and human well-being, and contributes to a more efficient fulfillment of the Bank's development mandate.

BSTDB has committed to allocate the necessary resources to ensure that its sustainability approach is effectively followed and implemented, is fully integrated into its operation cycle, and is applied in a systematic manner to all the operations financed by the Bank.

Climate Change

BSTDB acknowledges that climate change poses serious challenges to its Member States. They are vulnerable due to geographic location, under-investment in infrastructure, and aging infrastructure and machinery which are less able to cope with the changes in climatic conditions. BSTDB also recognizes that its operations may play a role in climate change at the regional level, but also that its operations may be directly affected by climate change due to more extreme weather like rising sea levels, desertification, and temperature shifts; in particular, in such sectors as hydropower generation, ports and coastal infrastructure, and water intensive industries.

The Bank therefore welcomed the Conference of Parties (COP) of the UN Framework Convention on Climate Change (UNFCCC) held in Paris on 30 Nov – 12 Dec 2015, and the adoption of the Paris Agreement, as well as the fact that the BSTDB's Member States supported the agreement and committed to reduce their emissions in line with their Nationally Determined Contributions.

To re-iterate BSTDB's commitment stated in the Environmental and Social Policy, it is to contribute to addressing climate change at the regional level by supporting operations that reduce emissions, apply energy efficiency, cleaner production, and use of renewables, as well as respond to calls for the financial institutions, as stated in the Paris Agreement, to play a more active role in mobilizing resources to shift the economies to low-carbon models. The Bank thus took a strategic decision to apply for Observer status to COP. The Observer Intergovernmental Organization (IGO) status was officially granted to BSTDB at COP23 held in Bonn during 6–17 November 2017. President Delikanli in his statement for the High Level Segment of COP23 stressed that BSTDB will take more action to address climate change, and will join forces with other institutions, financial and non-financial,

and together contribute to the global efforts of combating this phenomenon.

On December 12, at the 2017 One Planet Summit in Paris, BSTDB, proudly joined member institutions of the International Development Finance Club (IDFC) and major Multilateral Development Banks (MDBs) to collectively align their financial flows with the 2015 Paris Agreement on Climate Change. By subscribing under the Joint IDFC-MDB Statement, BSTDB further committed to embed climate change issues into its financing strategies, mobilize capital, and collaborate with partners and Member States to increase the support for low-carbon and climate resilient sustainable development.

Altogether, 2017 was an important and notable year for BSTDB in terms of joining global efforts in tackling climate change, and engaging in formulating its own climate change agenda responding to the calls of Paris Agreement, but at the same time taking into account its own unique mandate, and responding to the specific needs of its shareholders.

International Cooperation

Since its establishment, the Bank has been closely cooperating with its partner Multilateral Financial Institutions (MFI) within the Working Group on Environmental and Social Standards (WGESS). WGESS is a high-level forum represented by the key environmental and social representatives of MFIs and development agencies around the world, aimed at harmonizing the environmental and social assessment practices by sharing experiences, discussing issues of concern, developing common approaches, and working in partnership.

On 17–19 of May 2017, BSTDB was honored to host the Spring Session of the WGESS at its premises in Thessaloniki. The working group focused on issues of common interest like monitoring and reporting on environmental and social performance, using country safeguards systems, accountability and project redress mechanisms, outcomes of COP22 and actions, labor and working conditions, and energy and climate issues.

Similarly, BSTDB is actively involved at the European level in the European Development Finance Institutions (EDFIs) Working Group on Environmental and Social Issues. This is another high-level forum that brings together all the European Bilateral Financial Institutions to harmonize their environmental and social practices and achieve higher development effectiveness of their financing.

Participants at the Spring Sessions of WGESS hosted by BSTDB in Thessaloniki, May 17–19, 2017

Annual Evaluation Overview

Independent Ex-Post Evaluations

A. Introduction

According to the BSTDB's Evaluation Policy, the Independent Evaluation Office of the Bank presents this annual evaluation overview to highlight key findings and trends from the conducted post-evaluations since 2001.

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

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

The annual evaluation overview presents a synthesis of the findings of the Bank's evaluated operations over the past 15 years, focusing on BSTDB's mandate fulfillment and overall performance. It preserves the Bank's corporate memory by distilling the essence of 'Lessons Learned' from the Bank's evaluations in a diversity of operations.

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

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

The current evaluation overview provides an overall picture of BSTDB performance over the period of 2002–2017, highlighting the latest trends and developments (2013–2017) based on the analysis of 121 evaluations of completed operations and a dozen of related evaluation studies.

The analysis covers three five-year periods, to smooth-out annual fluctuations, as required by the applicable evaluation methodology. The 2013–2017 data is compared with the target of reaching 70% positively performing sample of evaluated operations set in the Bank's previous and current Medium-Term Business Plans.

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

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

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

C. Performance of Evaluated Operations

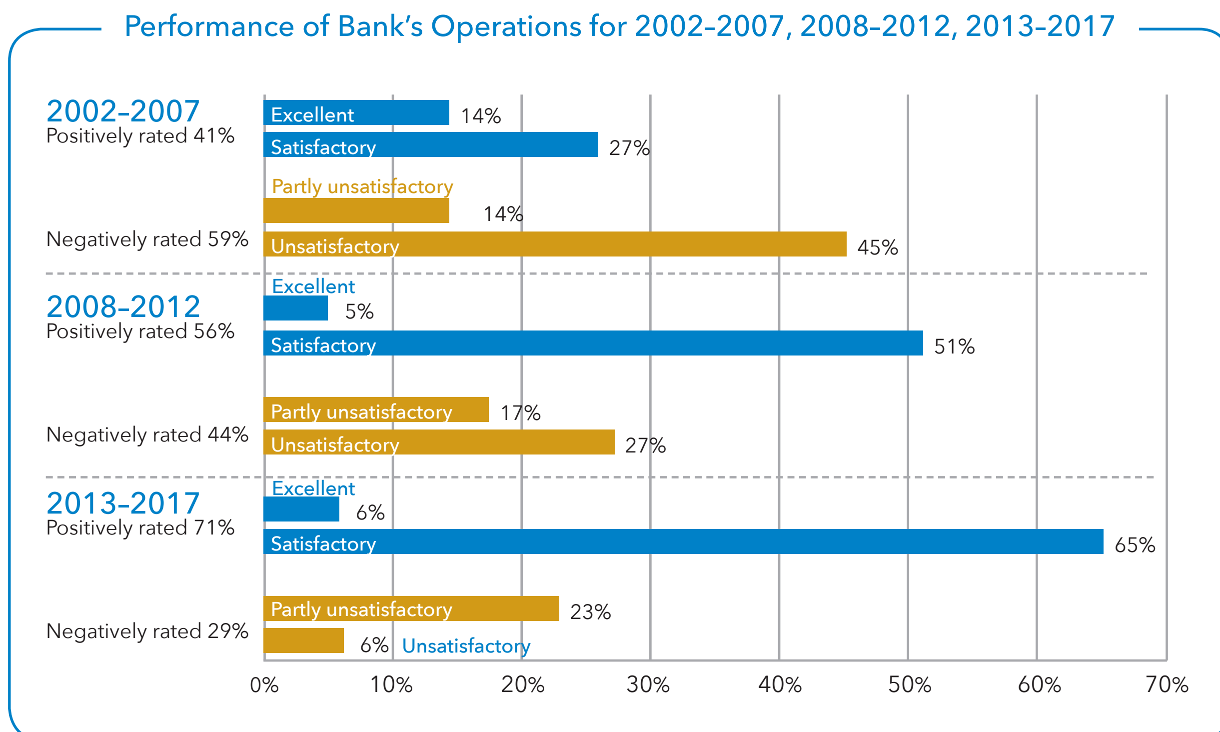
C.1 Overall Performance

In the latest aggregate period (2013–2017) BSTDB's positively rated operations represent 71%, above the target of 70% set by the Bank's Medium-Term Strategy 2015–2018. This denotes a positive trend compared to previous five-year periods (upwards from 41% in 2002–2007 and 56% in 2008–2012).

On the upper end of the ratings, the share of 'Excellent' ratings moved from 14% in 2002–2007, to 6% in 2013–2017.

The share of BSTDB operations rated negatively (Partly Unsatisfactory or Unsatisfactory), indicates improvement, as the lowest-rated share (Unsatisfactory) decreased from 43% in 2002–2007 to 6% in 2013–2017.

Performance of Bank's Operations for 2002-2007, 2008-2012, 2013-2017

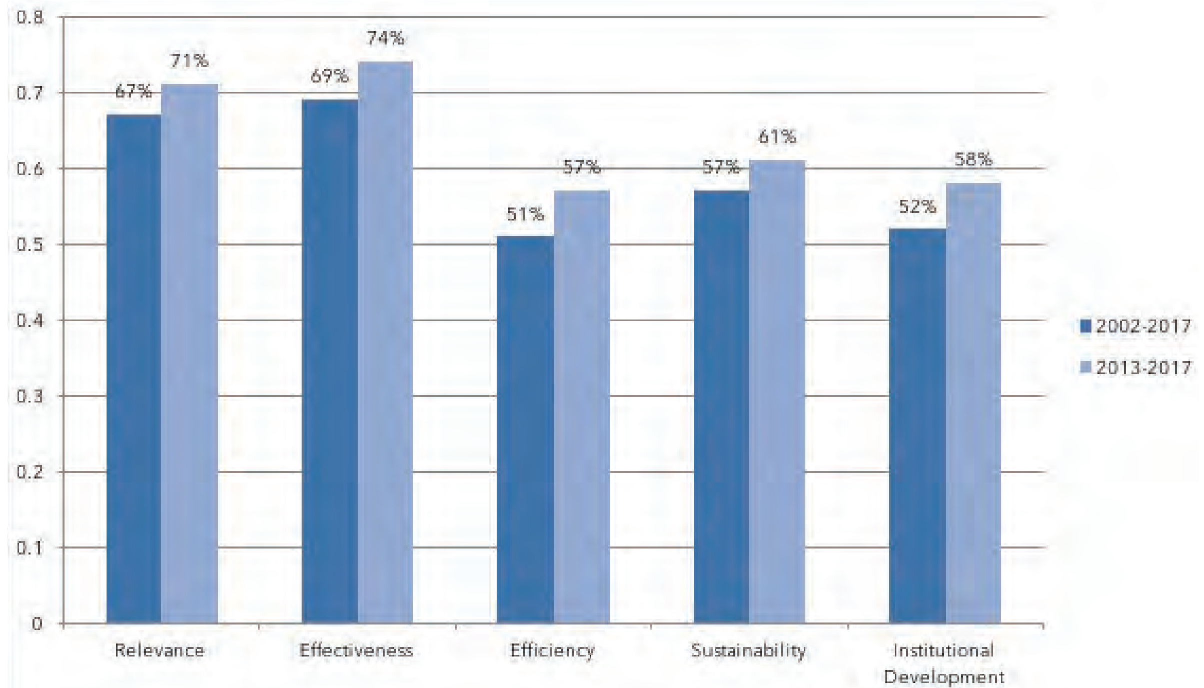


C.2 Relevance, Effectiveness, Efficiency, Sustainability and Institutional Development

A more analytical review of the evaluation ratings under each of the five criteria (Relevance, Effectiveness, Efficiency, Sustainability and Institutional Development) is helpful to understand the broader picture, as well as where the Bank needs more efforts, to enhance overall performance. An outline of the share of positively-rated operations, out of all 121 evaluated operations since 2002, is presented below:

- Relevance of operations – 67% (2002–2017) and 71% (2013–2017) positively rated
- Effectiveness – 69% (2002–2017) and 74% (2013–2017) positively rated
- Efficiency – 51% (2002–2017) and 57% (2013–2017) positively rated
- Sustainability – 57% (2002–2017) and 61% (2013–2017) positively rated
- Institutional Development – 52% (2002–2017) and 58% (2013–2017) positively rated

Performance Details: 2002-2017



D. Key Performance Indicators

Since 2016, the Independent Evaluation Office overviews the Key Performance Indicators (KPIs), approved by the Board of Governors as part of the Bank's MTSBP 2015–2018. While there are 8 KPIs, the overview focuses on the following two as they are directly related to the evaluation of the Bank's mandate implementation:

- *Mandate fulfillment* – 70% or higher share of ex-post evaluated operations to rate positive on overall performance (combined Relevance; Effectiveness; Efficiency; Sustainability and; Institutional Development). Result: achieved (71%)
- *Portfolio Concentration* – Herfindahl-Hirschman Index below 1400 (HHI, a commonly accepted measure of market concentration, calculated by squaring the portfolio share in each country, and then summing the resulting numbers), as well as a share of financial sector operations below 45%.

  Result: achieved (HHI 1300; financial sector share of 36%)

E. Independent validation of self-evaluation reports

The Bank's Operation Teams prepare self-evaluation reports on each operation (Operation Completion Reports - OCRs). The Independent Evaluation Office's evaluation normally differs in performance ratings relative to the ratings assigned by the operation teams in the respective OCRs. The divergence between the OCRs and the independent evaluations, expressed in binary terms (i.e. reflecting only the cases where the independent evaluation resulted in a change from positively rated self-evaluation to negatively rated[7], or vice-versa) is as follows:

- The overall OCR performance ratings issued during 2013–2017 were validated by the Evaluation Office without change in 67% of the cases.
- For the same period, the OCR ratings that were upgraded and downgraded by the independent evaluation were 0% and 33% of the total, respectively.

7 Positive: Excellent or Satisfactory; Negative: Partly Unsatisfactory or Unsatisfactory

F. Benchmarking with peer IFIs

All aspects of evaluated performance are subject to rigorous peer IFI benchmarking since 2004. These comparisons are conducted regularly on the basis of data and time aggregation, to ensure validity and overall consistency.

Since 2008 BSTDB maintains its performance generally in line with the comparable IFIs. The increase in the share of well-performing operations from 41% in 2007 to 71% in 2016 came as a result of proactive measures to analyze and mitigate shortfalls, such as volume-dominated incentives ('approval culture' - focusing on volumes of new operations with less effort on the quality and sustainability), as well as related waves of premature cancellations.

The last five-year data place the Bank within the average performance range among IFIs.

During recent years, the Bank's portfolio structure with reference to other IFIs and the Bank's own targets revealed a relatively high share of financial sector operations. However, in 2015, 2016 and 2017 the Bank was able to reduce this share to 36%, well below the threshold level of 45%, set by the Bank's Medium-Term Strategy 2015–2018.

G. Follow-up of evaluation recommendations

To date, all evaluation recommendations accepted by the Management, Audit Committee and the Board of Directors have been either implemented or are being implemented. There are no outstanding issues.

H. Conclusion

There is a consistent upward trend, with the latest results (71%) in line with the target of 70% positively-rated operations set in the Bank's Medium-Term Business Plan. Since 2008, BSTDB maintains its performance generally in line with the comparable IFIs, indicating certain advantages and lags. The Bank will continue to perform peer benchmarking, both generally and with a particular focus, to stay abreast of good practice and the latest developments in development finance.

Use of Resources

RESOURCES MANAGEMENT

Human Resources

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

HR Development

2017 was marked by the implementation and improvement of certain important HR policies. Important modifications to the recruitment and appointment policy were identified and implemented; important modifications to the performance management system were suggested; a comprehensive revision of the benefits and allowances policy was conducted; and the testing of the new electronic leave administration system was completed.

Following is a more detailed description of these achievements:

The revision of the recruitment and appointment policy was to standarize and regularize the various personnel engagement practices currently existing at the Bank, while maintaining the degree of flexibility required to address unforeseen temporary personnel needs. In addition, lessons learned from important recruitments in 2016, some of which were through an executive search company, prompted the introduction of important modifications to the selection process, including expanding the selection base for general service positions.

A new performance management system was implemented as of 1 January 2016. This system features increased objectivity, introduces performance-related rewards, and links individual performance to the institution's performance through a process of cascading objectives at different organizational levels. Institutional objectives are cascaded down from the institutional to the departmental level and thus are included in the calculation of individual performance scores. The experience gained in the first year of the system's implementation necessitated a review of these objectives to ensure the comprehensiveness and accuracy of the cascading process, and prompted suggestions on the modification of the system's structure within the same conceptual framework.

A thorough revision of the Bank's benefits and allowances system resulted in identifying modifications aimed at streamlining certain administration processes. Based on the lessons learned and the best practices of the other IFIs, the Bank was also able to increase the flexibility of the system to benefit the staff at no additional cost.

In 2017, the Bank made significant progress towards the ultimate goal of transferring most of its HR processes to the SAP platform. More specifically, testing the personnel, organization,and time management modules was finalized.

Staffing and Recruitment

The BSTDB conducts recruitment on a wide geographical basis. While preference is given to citizens of the member countries, recruitment is competitive and is based on the candidates' professional qualifications. As of the end of 2017, the Bank's total headcount was 111 full-time employees and 1 part-time employee.

Staff Development

The BSTDB offers learning opportunities, addressing its staff's development needs of its staff within the context of organizational business requirements. The policy on training, learning and development establishes a clear link between the institution's business needs and developing the professional and technical skills of the staff. In 2017, the share of the staff's learning and development needs addressed through in-house group training activities continued to increase.

Staff Benefit System

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

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

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

Information Technologies

IT has become an integral part of the organization and its business. In today's digital world, business processes are more depended on IT than at any other time. Therefore, IT is not just a support function but is part of the business.

Information Management is key for the Bank to carry out its day-to-day work. The Bank uses Opentext's Enterprise Information Management (EIM) and Content Suite 16 version to manage its information. The IT Department uses the latest version of Opentext, Content Suite 16 (CS16) capabilities (workspaces, Smart Views) and has developed applications for the Legal Department and the Banking Division to automate the Bank's Operations/Projects Life Cycle (OLC). This has led BSTDB to win the 2017 EIM Innovation Award in the Enterprise World 2017 in Toronto, Canada, organized by Opentext. The Content Suite 16 offers a user interface which is clean, easy to use, and works on any device (desktop, laptops and smart devices). This allows BSTDB staff access business information when they are with customers in the field. Opentext's Connected Workspaces allows us to connect content management to business processes, effectively giving a 360-degree view of a project in one place regardless of where the information originates.

With the personalized capabilities the new version of the Content Suite 16 offers, new team members can be onboarded much faster and are easily able to access the content they need and improve collaboration within the business unit and the project. Also, Opentext (Extended ECM for SAP) provides integration with SAP, where project information can be viewed from within the project workspace, providing a single point of access to information. A number of web-based reports have been created to give the BSTDB staff a quick view of the projects online, to monitor the progress of a project from within the EIM system.

We continue to improve the SAP Human Capital Management (HCM) system by providing a number of reports to users and to the HR staff to better view and access information from a single repository. New staff joining the organization or staff departing the organization are managed though the SAP HCM system recording all movements and approvals.

Also, we continue to improve the services we offer to our staff by upgrading our storage infrastructure using flash memory to increase access to application and information and adding capacity to our private cloud storage.

External Relations and Communications

The BSTDB external relations and communications activities aim to support the achievement of the Bank's strategic institutional and business objectives by promoting corporate image and increased awareness of the Bank in the Black Sea Region and beyond. In 2017, the Bank enhanced institutional cooperation with the development community, business partners, and other stakeholders while improving corporate transparency in line with international best practices.

Strengthening collaboration with partners in development for the benefit of the Black Sea Region

During the year, the Bank promoted synergies and business contacts with peer IFIs and other development institutions to facilitate the co-financing of operations in the Region and the exchange of information and best practices.

In March 2017, BSTDB granted Observer Status to the Asian Development Bank (ADB), which is expected to boost cooperation between the two development banks in the common countries of operation: Armenia, Azerbaijan and Georgia. ADB became BSTDB's twelfth Observer institution.

Also in March, BSTDB signed a Memorandum of Understanding (MoU) with the Global Infrastructure Hub to help unlock private investment to fund much-needed public infrastructure and to accelerate investment flows in the Black Sea Region.

In June, the Bank concluded an MoU with the Russian Federal Corporation for Small- and Medium- Sized Entrepreneurship. This was in the framework of the flagship St. Petersburg International Economic Forum to facilitate access for Russian enterprises to much-needed medium- and long-term financing to support promising investment projects in priority areas. Furthermore, the MoU aims to facilitate increased involvement of SMEs in the procurement activities of major public companies engaged in foreign trade, in particular in the Black Sea Region.

On the occasion of the BSTDB Regional Business Forum held on 3 July in Chisinau, the Bank signed an MoU with the National Bank of Moldova to facilitate access to international expertize and technical assistance in the banking sector. It also signed an MoU with the Chamber of Commerce and Industry to improve the Bank's outreach and awareness of its products and services with the Moldovan business community, especially outside the capital.

In November, during the Bank's presentation for the Ukrainian business community in Kiev, an MoU was signed with the Chamber of Commerce and Industry of Ukraine to jointly promote BSTDB operations in the country.

Leading multilateral consultations on the development agenda

BSTDB continued to actively contribute to multilateral consultation mechanisms established by development finance institutions to facilitate knowledge sharing and promote developmental effectiveness. During 2017, BSTDB chaired and hosted IFIs meetings on the Environmental and Social Standards, International Accountability Mechanisms, Information Disclosure and Stakeholder Engagement, as well as meetings of the European Chief Compliance Officers and Heads of Procurement of Multilateral Development Banks.

Contributing to international efforts to tackle climate change

In November, BSTDB became an Observer to the Intergovernmental Organization to the Conference of the Parties of the United Nations Framework Convention on Climate Change. The Observer status will open opportunities for the Bank's closer cooperation with the United Nations and other international organizations in tackling climate change.

In December, at the 2017 One Planet Summit in Paris, BSTDB signed a Joint Statement by member institutions of the International Development Finance Club and major Multilateral Development Banks in an effort to collectively align their financial flows with the 2015 Paris Agreement on Climate Change. The Bank committed to further embed climate change issues into its financing strategies, mobilize capital, and collaborate with partners to increase the support for low-carbon and climate-resilient sustainable development.

Promoting regional cooperation and supporting business generation

BSTDB maintained strategic support for regional cooperation, contributing to the joint efforts of the Organization of the Black Sea Economic Cooperation (BSEC) and its family regional institutions, with special attention to maintaining close collaboration with the Parliamentary Assembly of BSEC. BSTDB further strengthened its involvement and support for BSEC project-oriented activities.

To facilitate new business generation, BSTDB continued a series of business presentations in member countries started in 2015. In March-June 2017, the Bank presented its strategy and products to the business communities in Armenia, Ukraine and Azerbaijan in cooperation with local Chambers of Commerce and business associations.

On 3 July 2017, on the occasion of BSTDB's Annual Meeting in Chisinau (Moldova), BSTDB held a regional Business Forum titled 'Moldova: Working Together to Support Growth' under the auspices of the Moldovan Government and in close cooperation with the Ministry of Finance, the Chamber of Commerce and Industry, and the European Business Association of the Republic of Moldova. The event gathered nearly 300 business participants from Moldova and other countries of the Black Sea Region. At the Forum, economic policy makers, business leaders and representatives of development financial institutions exchanged views on best practices to support increased investments and sustainable growth in the country, focusing particularly on banking sector reforms and access to capital for businesses. The Forum offered a good opportunity to present Moldova's investment priorities and opportunities to the international financial and development community. BSTDB used the event to promote its business contacts with Moldovan banks and companies, with over

40 bilateral meetings held by BSTDB bankers with interested participants.

In 2017, the BSTDB President, senior management and staff promoted the Black Sea Region as an investment destination and shared the Bank's expertise on doing business in the Region at major international events, including the Euromoney Central and Eastern European Forum (Vienna), Global Infrastructure Summit (Berlin), Organization of Islamic Countries' Forum (Beijing), Delphi Economic Forum (Delphi, Greece), Eurasian Economic and Investment Forum (Thessaloniki), Balkans and Black Sea Forum (Serres, Greece) and other international conferences.

Operational Developments

Temporary Recovery Coordination Committee

To enhance the management of its problematic operations and ensure a timely, coordinated and efficient approach, the Bank established a Temporary Recovery Coordination Committee (TRCC) in the second quarter of 2017, comprised of senior staff and members of the top management. The TRCC regularly reviews all problematic operations, facilitates an open discussion on alternative action plans, and recommends to the Credit Committee an effective strategy with concrete steps to maximize asset recovery for the Bank.

Recovery success

In the third quarter of 2017, the Bank's recovery unit led the efforts among senior lenders for the adoption of a reorganization plan for a major steel manufacturing company, helping the company to restart its operations and retain a workforce of over 500 skilled employees.

Nominee directors

In the second quarter of 2017, the Bank competitively selected and appointed its first external nominee director to a financial institution client, moving one step ahead in following international best practices on director nominations to investee companies.

Administrative Services

During 2017, the Administrative Services Department continued efforts to improve the overall efficiency of the department and provide a higher quality of service to the Bank's staff.

- Space utilization: New archive areas were established in Banking, Finance, and Operations to meet safety standards for the corresponding records and permit a better allocation of space and the creation of a more productive work environment.
- Security: A new entrance & access control system was implemented to strengthen the external security of the premises and improve monitoring of access to the Bank's facilities.
- Work-life balance facilities: The personal exercise facilities of the Bank were extended to better respond to the needs of employees visiting the Bank's gym, while storage spaces for employees' bicycles were tripled in number.

Business Volume

In 2017, the Bank's total assets were EUR 1,514,926 thousand at the end of the year against EUR 1,665,871 thousand at end 2016. The Bank maintained the size of the loan and equity portfolios balance at EUR 1,166,442 thousand compared to EUR 1,191,838 thousand in the previous year. Funds committed but not yet disbursed stood at EUR 185,563 thousand at the end of the year, higher than the previous year by EUR 25,372 thousand.

Revenues

Interest income from lending activities was EUR 61,512 thousand for the year, marginally lower than EUR 61,806 thousand in 2016. Treasury activities in 2017 generated interest income of EUR 8,293 thousand from its investment portfolios, much higher than in the previous year of EUR 6,170 thousand. Operating income for the year was EUR 38,422 thousand against EUR 30,816 thousand for 2016, representing an increase of 25%.

Expenses

Interest and similar expense for the year was EUR 42,037 thousand compared to EUR 38,171 thousand in 2016, derived from the borrowing amounts. The Bank will continue to carry required borrowings to fund the lending activities.

Administrative expenses in 2017, including depreciation, were EUR 19,741 thousand, a marginal increase of EUR 652 thousand over the previous year. Administrative expenses include salaries, benefits and other administrative costs.

Personnel expenses, to the amount of EUR 14,775 thousand, showed an increase of EUR 458 thousand from the previous year due to the increase in the average number of staff. Other administrative costs also had an increase from the previous year to an amount of EUR 323 thousand.

Overall, administrative expenses were well within the 2017 Budget, reflecting the Bank's focus on budgetary discipline and effective cost controls.

Net Income

Income before impairment during the year was EUR 18,681 thousand compared to EUR 11,727 thousand in 2016, achieving an increase of 59%. Net impairment losses to an amount of EUR 9,409 thousand were primarily due to the introduction of IFRS 9 (International Financial Reporting Standards), an early adoption of this accounting standard. Impairment of financial instruments, assessment of whether credit risk on the financial asset has increased since initial recognition, has now incorporated forward-looking information in the measurement of the expected credit loss. In addition, a net fair value loss of EUR 617 thousand was recorded due to fair value adjustments to some of the Bank's investments measured at fair value through profit or loss.

The Bank posted net income of EUR 8,655 thousand for the year. Under the challenging economic conditions, the Bank continues to pay attention to the quality of its lending portfolio by enhancing monitoring and taking proactive measures to deal with potential problematic operations at early stage.

Business Model

The Bank has adopted the following business models:

- Hold to Collect – financial assets held with the objective to collect contractual cash flows.
- Hold to Collect and Sell – financial assets held with the objective of both collecting contractual cash flows and selling financial assets.
- Other – financial assets held with trading intent or that do not meet the criteria of either 'Hold to collect' or 'Hold to collect and sell'.

Adopting these business models required judgment based on facts and circumstances at the date of the assessment. The Bank has considered quantitative factors (e.g. the expected frequency and volume of loan and equity portfolios), and qualitative factors such as how the performance of the business model and the financial assets held within that business model are evaluated and reported to the Bank's key management personnel.

Solely Payments of Principal and Interest ('SPPI')

If a financial asset is held in either (i) a Hold to Collect or (ii) a Hold to Collect and Sell business model, then an assessment to determine whether contractual cash flows are solely payments of principal and interest on the principal amount outstanding at initial recognition is required to determine the classification.

Contractual cash flows that are SPPI on the principal amount outstanding are consistent with a basic lending arrangement. Interest is

consideration for the time value of money and the credit risk associated with the principal amount outstanding during a particular period of time. It can also include consideration for other basics as (i) liquidity and foreign exchange risks (ii) borrowing costs (iii) administrative costs, which are associated with holding the financial asset for a particular period of time and (iv) a profit margin that is consistent with a basic lending arrangement.

Capital Base

Initial Share Capital

The initial authorized share capital of the Bank was EUR 1.15 billion divided into one million shares having a par value of EUR 1,150 each. Member States subscribed to all of the initial authorized share capital. Each of Armenia, Georgia and Moldova voluntarily agreed to reduce its share from 2% to 1% in June 2004 leaving EUR 34.5 million unsubscribed. At the Board of Governors meeting in October 2008, it was decided that Azerbaijan would take up this 3% of unsubscribed shares. The additional subscription amount was fully paid in 2009.

New Share Capital

The Board of Governors decided in December 2007 to approve an increase to the Bank's authorized capital from EUR 1.15 billion to EUR 3.45 billion. They further approved a EUR 1.15 billion increase in the subscribed capital to be subscribed by the existing Member States, thereby increasing subscribed capital to EUR 2.3 billion. An announcement that this additional EUR 1.15 billion was fully subscribed was made after the Board of Governors meeting in October 2008. Georgia declined to take up its allocation and this was taken up by Romania. Upon completing the subscription, Greece, Russia and Turkey remained the largest shareholders of the Bank with 16.5% stake each, followed by Romania with 14%, Bulgaria and Ukraine with 13.5% each, Azerbaijan with 5%, Albania with 2%, Armenia and Moldova with 1% each, and Georgia with a 0.5% stake. In October 2011, the Board of Governors accepted Moldova's request and reduced its portion of the subscribed capital from 1% to 0.5% and, therefore, those shares were released to unallocated.

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

- Payment of the paid-in portion of the new subscribed capital, equivalent to 10% of the subscribed number of shares (totaling EUR 115 million), was to be paid in cash by the Member States in 2010.
- Payment of the paid-in portion of the new subscribed capital, equivalent to 20% of the subscribed number of shares (totaling EUR 230 million), was to be made by each Member State in eight equal successive annual installments between 2011 and 2018.
- Payment for the remaining callable portion of the new subscribed capital, equivalent to 70% of the shares (totaling EUR 797 million), represents a firm commitment on the part of the Member States to pay such amount when due in conformity with the relevant provisions of the Establishing Agreement.

As of 31 December 2017 the paid-in share capital was EUR 641,566 thousand.

The Board of Governors may also authorize additional subscriptions from the remaining EUR 1.15 billion of authorized capital in three instances:

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

Gearing Ratio

The Bank's institutional gearing ratio, the statutory limit on the total amount of ordinary operations (outstanding loans, equity investments, and guarantees) is 150% of the Bank's unimpaired subscribed capital, reserves, and surplus, which at the end of 2017 stood at about EUR 3.6 billion.

The operational gearing ratio was set at 100% of the Bank's unimpaired paid-up capital, reserves, and surplus and the usable portion of callable capital, which limits the total amount of operations to approximately EUR 2.3 billion.

Provisioning

With the adoption of IFRS 9, the Bank measures the expected credit losses ('ECL') of a financial asset as a probability-weighted estimate of credit losses and the corresponding weighting of the respective risk of default. The Bank applies two types of provisions for impairment as follows:

- For Stage 1 operations: Assessed on 12-month ECL basis are the expected credit losses that result from all possible default events of a financial instrument, within the 12 months after the reporting date.
- For Stages 2 and 3 operations: Assessed on Lifetime ECL basis are the expected credit losses that result from all possible default events over the remaining life of a financial instrument.

The Lifetime basis applies to (i) exposures not credit impaired or (ii) exposures that are credit impaired, including those exposures which are non-performing.

According to IFRS 9, ECL should reflect an unbiased and probability-weighted amount determined by evaluating a range of possible outcomes and the time value of money; as well as reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions. The Bank evaluates a range of possible outcomes to measure ECL, and considers 3 core scenarios (adverse, basic and favorable) which reflect forecasts of future conditions in each Member State and are incorporated in the probability of defaults ('PDs') during the calculation of ECL. Probability weights are applied to each scenario for which ECL is calculated.

A loss allowance for expected credit losses is recognized on financial assets that are measured at amortized cost, at fair value through other comprehensive income, lease receivables, contract assets or loan commitments and financial guarantee contracts. At each reporting date, the Bank recognizes loss allowances based on either 12-month ECL or lifetime ECL, depending on whether there has been a significant movement in credit risk on the financial instrument since its initial recognition. As such, the Bank records three stages of provisions for impairment as (i) Stage 1: 12-month ECL (ii) Stage 2: lifetime ECL, for operation that are not credit impaired and (iii) Stage 3: lifetime ECL, for operations that are credit impaired and/or non-performing.

At the end of 2017, total provisions for loans measured at amortized cost stood at EUR 47,996 thousand, equivalent to 4.2% of the respective outstanding loan exposure. The institutional target to be achieved for stage 1 and stage 2 provisions and reserves, over time, is set at 10% of total outstanding exposure, less the gross value of stage 3 operations.

Reserves and Surplus

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

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

Market Risks

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

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

Operational Risks

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

Appropriate measures are taken to achieve a high level of operational risk awareness and to enhance the operational risk management system. The Bank adopts market best practices and methods to manage and coordinate its operational risks. Key processes for managing operational risk include, amongst others: (i) internal controls (e.g. the 'four eyes principle', proper segregation of

duties) within its offices and departments, (ii) the establishment of disaster recovery and business continuity plans that account for different types of plausible scenarios to which the Bank may be vulnerable, (iii) the constant safe storage of the Bank's Vital Records, (iv) the purchase of corporate and property insurance policies to confront potential losses which may occur as a result of various events and natural disasters, and (v) the approval process of New Products to identify and assess the operational risk related to each new product, activity, process, and system.

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

Should the Bank quantify the operational risk embedded in its operations, it would, with the use of SA, amount to EUR 11.6 million for 2017 and EUR 9.6 million for 2016, constituting a fraction of the Bank's total reserves, which represents the ultimate protection of the Bank's capital against impairment resulting from credit losses in excess of provisions, or losses due to market, operational, and compliance risks. There is no general accepted methodology for calculating risks associated with compliance and other 'black swan' type events.

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

Short-Term Liquidity

As indicated in the statement of cash flows, the Bank's short term liquidity totaling EUR 196 million as of 31 December 2017 was invested in two types of money market instruments:

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

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

Borrowings Utilized

As of end 2017, the Bank had issued several fixed rate bonds: for USD 500 million, for CHF 100 million and for RON 102 million, the proceeds of which were swapped to meet the Bank's currency funding requirements through the use of derivative instruments.

The Bank issued a total of EUR 7 million Schuldschein. The Bank had also issued two Georgian domestic fixed-rate bonds totaling GEL 108 million and one Armenian domestic fixed-rate bond totaling AMD 2 billion, to fund loans in local currency. In addition, the Bank had outstanding borrowings totaling EUR 167 million, primarily from other IFIs and National Development Banks.

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

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, audited, financial statements. This is followed by cash flow modeling for the life of the proposed operation and stress testing of key assumptions. For financial institutions, risk analysis is based on quantitative methodology (i.e. capitalization, asset quality, liquidity, and foreign exchange risk) supported by comparisons of key ratios to industry standards. The Bank issues internal credit ratings to each operation based on proprietary and leased analysis tools closely compatible with methodologies used by Moody's.

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

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

Risk Mitigation

The Bank will normally require its operations to benefit from some form of security or risk-sharing 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.

Independent Evaluation

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

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

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

Preferred Creditor Status

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

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

Management Structure

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

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

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

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

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

Compliance

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

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

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

Reporting and Disclosure

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

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

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

Internal Audit

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

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

Enterprise Risk Management

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

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

External Auditors

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

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

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

Financial Statements for the Year Ended 31 December 2017

Together with Auditor's Report

Responsibility for external financial reporting

Management's responsibility

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

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

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

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

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

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

The Bank has assessed its internal controls over external financial reporting for 2017. The Bank's assessment was based on the criteria for effective internal controls over financial reporting described in the 'Internal Control – Integrated Framework' issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Based on this assessment, management asserts that, at 31 December 2017, the Bank maintained effective internal controls over its financial reporting as contained in the Financial Statements for 2017.

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

Ihsan Ugur Delikanli
President

Valentina Siclovan
Vice President, Finance

Black Sea Trade and Development Bank
Thessaloniki
15 June 2018

Independent Reasonable Assurance

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

Report on the effectiveness of internal control over financial reporting

We were engaged by the Board of Directors of the Black Sea Trade and Development Bank ('the Bank') to report on the effectiveness of the Bank's internal control over financial reporting as of 31 December 2017, in the form of an independent reasonable assurance conclusion about whether the internal control over financial reporting is effective based on criteria established in 'Internal Control - Integrated Framework' issued by the Committee of Sponsoring Organisations of the Treadway Commission (the COSO criteria).

The Bank's responsibilities

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

Our responsibilities

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

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

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

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

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

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

Conclusion

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

In our opinion, Black Sea Trade and Development Bank maintained, in all material respects, effective internal control over financial reporting, as of 31 December 2017, based on the COSO criteria.

KPMG Certified Auditors AE
Athens, Greece
15 June 2018

INCOME STATEMENT

For the year ended 31 December

Presented in thousands of EUR	Note	2017	2016
Interest income	7	69,805	67,976
Interest expense	8	(42,037)	(38,171)
Net interest income		**27,768**	**29,805**
Net fees and commissions	9	2,087	1,748
Dividend income	15	1,715	6
Net gains from equity investments through profit or loss	15	4,263	-
Net gains from debt investment securities through OCI		482	718
Foreign exchange income (losses)		2,110	(1,488)
Other (loss) income		(3)	27
Operating income		**38,422**	**30,816**
Personnel expenses	10,26	(14,775)	(14,317)
Other administrative expenses	10	(4,505)	(4,182)
Depreciation and amortization	17,18	(461)	(590)
Income before impairment		**18,681**	**11,727**
Impairment (losses) on loans at amortized cost	11	(9,125)	(5,862)
Impairment (losses) on guarantees		(8)	(18)
Impairment (losses) on debt investment securities through OCI	12	(276)	-
Fair value (losses) on loans through profit or loss	14	(2,217)	-
Fair value gains (losses) on equity investments through profit or loss	15	1,600	(4,096)
Net income for the year		8,655	1,751

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

STATEMENT OF OTHER COMPREHENSIVE INCOME

For the year ended 31 December

Presented in thousands of EUR	Note	2017	2016
Net income for the year		8,655	1,751
Other comprehensive income:			
Items that will not be reclassified to profit or loss:			
Remeasurements of defined benefit liability (asset)	23,26	231	(3,021)
Net change in equity investments financial assets	23	(21,641)	(908)
Items that are or may be reclassified to profit or loss:			
Net change in investment securities financial assets	23	2,347	(4,095)
Total comprehensive (loss) for the year		**(10,408)**	**(6,273)**

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

STATEMENT OF FINANCIAL POSITION

At 31 December

Presented in thousands of EUR	Note	2017	2016
Assets			
Cash and cash equivalents	25	81,481	70,034
Debt investment securities at fair value through other comprehensive income	12,25	292,524	414,539
Less: impairment losses	12	(276)	-
Debt investment securities net of impairment		292,248	414,539
Derivative financial instruments – assets	13	1,659	576
Loans at amortized cost	14,16	1,132,359	1,139,072
Less: deferred income	14	(6,219)	(7,626)
Less: impairment losses	11,14	(47,996)	(30,131)
Loans at fair value through profit or loss	14	2,722	-
Loans net of impairment		1,080,866	1,101,315
Equity investments at fair value through profit or loss	15,16	1,600	-
Equity investments at fair value through other comprehensive income	15,16	29,761	52,766
Equity investments at fair value		31,361	52,766
Property and equipment	17	501	510
Intangible assets	18	653	479
Other assets	19	26,157	25,652
Total Assets		**1,514,926**	**1,665,871**
Liabilities			
Borrowings	20	722,592	862,533
Derivative financial instruments – liabilities	13	18,242	35,100
Payables and accrued interest	21	15,422	15,568
Total liabilities		756,256	913,201
Members' Equity			
Authorized share capital	22	3,450,000	3,450,000
Less: unallocated share capital	22	(1,161,500)	(1,161,500)
Subscribed share capital	22	2,288,500	2,288,500
Less: callable share capital	22	(1,601,950)	(1,601,950)
Less: payable share capital	22	(44,984)	(72,741)
Paid-in share capital		641,566	613,809
Reserves	23,24	33,583	47,177
Retained earnings	24	83,521	91,684
Total members' equity		758,670	752,670
Total Liabilities and Members' Equity		**1,514,926**	**1,665,871**
Off-balance-sheet items			
Commitments	16	**185,563**	**160,191**

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

STATEMENT OF CHANGES IN MEMBERS' EQUITY

For the year ended 31 December

Presented in thousands of EUR	Share capital			Reserves	Retained Earnings	Total
	Subscribed	Callable	Payable			
At 31 December 2015	**2,288,500**	**(1,601,950)**	**(110,137)**	**53,450**	**91,684**	**721,547**
Total comprehensive income						
Net income for the year	-	-	-	-	1,751	1,751
Other comprehensive income:						
Fair value reserve (available-for-sale financial assets)	-	-	-	(5,003)	-	(5,003)
Remeasurement of defined benefit liability (asset)	-	-	-	(3,021)	-	(3,021)
Total comprehensive income	-	-	-	(8,024)	1,751	(6,273)
Transactions with owners of the Bank						
Members' contributions:						
Paid-in share capital	-	-	37,396	-	-	37,396
Transfer to general reserve	-	-	-	1,751	(1,751)	-
Total contributions and distributions	-	-	37,396	1,751	(1,751)	37,396
At 31 December 2016	2,288,500	(1,601,950)	(72,741)	47,177	91,684	752,670
Impact of adoption IFRS 9 at 1 January 2017	-	-	-	-	(11,349)	(11,349)
Restated balance at 1 January 2017	2,288,500	(1,601,950)	(72,741)	47,177	80,335	741,321
Total comprehensive income						
Net income for the year	-	-	-	-	8,655	8,655
Other comprehensive income:						
Fair value reserve (financial assets)	-	-	-	(19,294)	-	(19,294)
Remeasurement of defined benefit liability (asset)	-	-	-	231	-	231
Total comprehensive income	-	-	-	(19,063)	8,655	(10,408)
Transactions with owners of the Bank						
Members' contributions:						
Paid-in share capital	-	-	27,757	-	-	27,757
Transfer to general reserve	-	-	-	5,469	(5,469)	-
Total contributions and distributions	-	-	27,757	5,469	(5,469)	27,757
At 31 December 2017	**2,288,500**	**(1,601,950)**	**(44,984)**	**33,583**	**83,521**	**758,670**

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

STATEMENT OF CASH FLOWS

For the year ended 31 December

Presented in thousands of EUR	Note	2017	2016
Cash flows from operating activities			
Net income for the year		8,655	1,751
Adjustment for:			
Depreciation and amortization	17,18	461	590
Impairment losses	11,12	9,409	5,880
Fair value losses on loans at FVTPL	14	2,217	-
Fair value (gains) losses on equity investments at FVTPL	15	(1,600)	4,096
Net interest income		(27,768)	(29,805)
Foreign exchange adjustment on provisions	15	(2,124)	525
Operating (loss) before changes in operating assets		(10,750)	(16,963)
Changes in:			
Derivative financial instruments	13	(17,941)	17,582
Other assets	19	(1,143)	(2,904)
Accounts payable	21	622	3,360
Deferred income	14	(1,407)	(38)
Fair value movements	23	(19,294)	(5,003)
Cash generated from operations		(49,913)	(3,966)
Proceeds from repayment of loans	14	318,214	366,957
Proceeds from repayment of equity investments		9,408	4,926
Funds advanced for loans	14	(386,211)	(443,738)
Funds advanced for equity investments		(7,556)	(2,393)
Foreign exchange and other adjustments		91,542	(4,058)
Interest income received		70,443	61,594
Interest expense paid		(42,814)	(32,370)
Net cash from / (used in) operating activities		3,113	(53,048)
Cash flows from investing activities			
Proceeds from investment securities at FVTOCI (2016: AFS)		573,130	717,977
Purchase of investment securities at FVTOCI (2016: AFS)		(575,025)	(904,403)
Purchase of property, software and equipment	17,18	(630)	(474)
Net cash from / (used in) investing activities		(2,525)	(186,900)
Cash flows from financing activities			
Proceeds received from share capital	22	27,757	37,396
Proceeds from borrowings	20	106,736	618,977
Repayments of borrowings	20	(246,677)	(297,392)
Net cash from / (used in) financing activities		(112,184)	358,981
Net increase in cash and cash equivalents		**(111,596)**	**119,033**
Cash and cash equivalents at beginning of year	25	308,077	189,044
Cash and cash equivalents at end of year	**25**	**196,481**	**308,077**

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

NOTES TO THE FINANCIAL STATEMENTS

1. ESTABLISHMENT OF THE BANK

Agreement Establishing the Bank

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

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

As at financial position date the Bank's shareholders comprised of the following 11 countries: Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russian Federation, Turkey and Ukraine.

Headquarters Agreement

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

2. BASIS OF PREPARATION OF FINANCIAL STATEMENTS

Statement of Compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as published by the International Accounting Standards Board (IASB). The financial statements for the year ended 2017 were submitted by the Management Committee to the Board of Directors ('BoD') for approval on 15 June 2018, and were approved on that date.

Pursuant to Article 23 of the Establishing Agreement, these financial statements shall be subject to approval by the Board of Governors (BoG) in their Annual Meeting to be held on 1 July 2018.

Basis of Measurement

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

Functional and Presentation Currency

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

Judgments and Assumptions

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

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

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

3. SIGNIFICANT ACCOUNTING POLICIES

A summary of the Bank's accounting policies applied in the preparation of these financial statements are presented in this section. These policies have been consistently applied to all periods presented in the financial statements, except for that indicated in the note 'Changes in accounting policies'.

Foreign Currencies

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

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

			31 December 2017	31 December 2016
1 EUR	=	United States dollar	1.19930	1.05410
	=	Pound sterling	0.88723	0.85618
	=	Russian ruble	69.39200	-
	=	Azerbaijan manat	2.03070	1.86440
	=	Georgian lari	3.11690	2.78210
	=	Armenian dram	580.10000	-

Recognition and Derecognition of Financial Instruments

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

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

Cash and Cash Equivalents

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

Financial Assets

The Bank early adopted IFRS 9: Financial instruments, concerning the classification and measurement and impairment recognition, effective from 1 January 2017. In accordance to that adoption the Bank classifies the financial assets in the following categories:

- Those measured at amortized cost.
- Those measured at fair value, either (i) through the profit or loss or (ii) through other comprehensive income.

The above classification depends on both the contractual characteristics of the financial instruments and the business model adopted for their management, which is determined at the time of initial recognition. Financial assets that are subsequently measured at either amortized cost or debt instruments at fair value through other comprehensive income, are subject to provisions for impairment.

Treasury operations are recognized on a trade date basis, which is the date the Bank commits to purchase or sell the asset. All loans are recognized when cash is advanced to borrowers at settlement date.

Based on the Bank's credit policy, the Bank does not originate credit-impaired financial assets, nor does the Bank purchase credit-impaired assets as, for example, those loans would be acquired at a deep discount.

The Bank did not reclassify any non-derivative financial assets out of the fair value through profit or loss category in any particular circumstance nor did the Bank transfer any financial assets from the fair value through other comprehensive income category to the amortized cost category.

The Business Model applied to loan portfolio, treasury portfolio and equity investment portfolio is reassessed at each reporting period. The reassessment of Business Model has been established to determine if evidence initially used has been changed.

a) Financial assets, at amortized cost

Financial assets are classified at amortized cost only if both of the following criteria are met:

1. The objective of the Bank's business model is to hold the asset to collect the contractual cash flows; and
2. The contractual terms give rise on specified dates to cash flows that are solely payments of principal, and interest on the principal outstanding:
   (i) Principal is the fair value of the financial asset at initial recognition.
   (ii) Interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time, and for other basic lending risks and costs, as well as a profit margin.

The Bank's operations, which are non-derivative with fixed or determinable payments and with fixed maturities, meeting the above criteria are measured initially at fair value plus transaction costs and including any premium or discount that may arise on the date of acquisition. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the transaction cost. These financial assets are subsequently measured at amortized cost using the effective interest method, less any provision for impairment or uncollectability. All other fees and relating income generated are reported in the income statement, see note 'Net fees and commissions'. All such financial assets are recognized on settlement date.

These financial assets include cash and cash equivalents, loans and advances on amounts disbursed to operations, receivables accrued, and certain debt investments that meet the above criteria. Financial assets not meeting the above criteria as well as those financial assets designated are measured at fair value through profit or loss or at fair value through comprehensive income, as appropriate.

b) Financial asset, at fair value through profit or loss (FVTPL)

Financial assets that are classified at fair value through profit or loss are initially measured at their fair value and subsequently carried at fair value on the statement of financial position with all changes in fair value gains and losses and foreign exchange gains and losses, recognized in the income statement in the period in which they occur. Transaction costs on these financial assets are expensed in the income statement.

This category includes any treasury assets held for trading or resale to realize short-term fair value changes as well as any loan for which either of the criteria for recognition at amortized cost is not met. It can also include a debt instrument or an equity instrument that is not within the category,

nor measured, at fair value through other comprehensive income. Derivative instruments are also categorized as financial assets at fair value through profit or loss. All such financial assets are recognized on trade date.

In addition, a debt instrument that could meet amortized cost criteria can be designated and measured at FVTPL. This may be done, if such designation significantly reduces or eliminates a measurement or recognition inconsistency, referred to as an 'accounting mismatch', which would arise from measuring assets or recognizing the gains and losses using any other measuring base.

c) Financial assets, at fair value through other comprehensive income (FVTOCI)

c1. Debt instruments

Debt instruments are classified and subsequently measured at fair value through other comprehensive income only if both of the following criteria are met:

1. The objective of the Bank's business model is achieved by both collecting the contractual cash flows and selling the financial asset; and
2. The contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding:
   (i) Principal is the fair value of the financial asset at initial recognition.
   (ii) Interest consists of consideration for the time value of money, for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs, as well as a profit margin.

This category includes financial assets such as Euro Commercial Paper (ECP) or bonds that are intended to be held to maturity, which may or may not be sold in the future. Their fair value is determined by reference to quoted market bid prices. The unrealized gains and losses that arise from fluctuations in fair value are recognized as a separate component of equity until the financial asset is sold or derecognized for any other reason or until the investment is determined to be impaired, at which time the cumulative gain or loss previously reported in equity is included in income. Foreign exchange gains or losses and any income accrued, by using the effective interest rate method, are recognized directly in income. All such financial assets are recognized on trade date.

Financial assets not meeting the above criteria, as well as those financial assets designated shall be measured at fair value through profit or loss.

c2. Equity instruments

On initial recognition the Bank can make an irrevocable election, on an instrument-by-instrument basis, to designate investments in an equity instrument not held for trading nor contingent consideration, as a financial asset measured at fair value though other comprehensive income. Those not elected are measured at fair value through profit or loss.

After initial recognition at cost plus transaction costs, these financial assets are subsequently measured at fair value with all gains and losses arising from changes in fair value (realized and unrealized), including foreign exchange gains and losses, recognized in other comprehensive income as a separate component of members' equity. For those not purchased from an active market the fair value is determined using accepted valuation techniques. The valuation techniques used are net asset value and earnings-based valuations using comparable information and discounting cash flows. All such financial assets are recognized on settlement date.

The cumulative gains or losses are not reclassified, (i.e. not recycled), to income on disposal of the investments and no provisions for impairments are recognized in the income statement. However, the cumulative gain or loss after the investment is subsequently derecognized can be transferred within members' equity.

Dividends received are included in income.

Financial Liabilities

Financial liabilities include borrowings and other liabilities.

a) Borrowings

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

b) Other liabilities

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

Offsetting of Financial Assets and Liabilities

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

Derivatives

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

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

a) Hedge accounting

The Bank has chosen to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements of IFRS 9. The Bank has applied this accounting policy to all its hedging relationships.

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

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

If the hedging instrument expires or is sold, terminated or exercised, or where the hedge no longer meets the criteria for hedge accounting, the hedge relationship is discontinued prospectively. Any fair value adjustment is recognized immediately in the income statement. At the financial position date the Bank did not have any cash flow hedge.

i) Fair value hedge

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

Impairment

For the Bank, and in accordance with IFRS 9, a loss allowance for expected credit losses is recognized on financial assets that are measured (i) at amortized cost (ii) at fair value through other comprehensive income (iii) lease receivable contracts (iv) loan commitments and (v) financial guarantee contracts.

Financial instruments, including equity instruments, carried at fair value through profit or loss (FVTPL) are not subject to impairment requirements as their fair value reflects the credit of these exposures. Additionally, equity investments measured at fair value through other comprehensive income (FVTOCI) are also not subject to impairment requirements, but a negative reserve balance in relation to the carrying amount of that equity investment, e.g. representing an impairment loss, shall be recognized in other comprehensive income and shall not be recycled (reclassified and transferred) to net income or loss.

Definition of default

'IFRS 9 doesn't include an explicit definition of default. In particular, IFRS 9 B5.5.37 requires that when defining default for the purposes of determining the risk of a default occurring, an entity shall apply a default definition that is consistent with the definition used for internal credit risk management purposes for the relevant financial instrument and consider qualitative indicators (for example, financial covenants) when appropriate. However, there is a rebuttable presumption that default does not occur later than when a financial asset is 90 days past due unless an entity has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate'. The definition of default used for these purposes shall be applied consistently to all financial instruments unless information becomes available that demonstrates that another default definition is more appropriate for a particular financial instrument. The Bank's definition of default is based on the regulatory definition under Article 178 of the 'Regulation (EU) No 575/2013 of the European Parliament and of the Council of the European Union of 26 June 2013 on prudential requirements for credit banks and investment firms and amending Regulation (EU) 648/2012' (CRR). A default is considered to have occurred when either of the following conditions have taken place:

i) Qualitative

Unlikeliness to Pay (UTP) criterion: the Bank considers that the obligor is unlikely to pay its credit obligations to the Bank without recourse by the Bank to actions such as realizing security. Below are some elements taken as indications of unlikeliness to pay (in line with CRR (Article 178)).

a. The Bank puts the credit obligation on non-accrued status.

b. The Bank recognizes a specific credit adjustment resulting from a significant perceived decline in credit quality subsequent to the institution taking on the exposure.

c. The Bank has filed for the obligor's bankruptcy or a similar order in respect of an obligor's credit obligation to the institution, the parent undertaking or any of its subsidiaries.

d. The obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of a credit obligation to the institution, the parent undertaking or any of its subsidiaries.

ii) Quantitative

Past due criterion: the exposure is past due more than 90 days on any credit obligation to the Bank.

The definition of default is applied in the relevant parameters used for the expected credit losses (ECL) measurement, those being the exposure at default (EAD), probability of default (PD), and loss given default (LGD) models.

a) Financial assets

The impairment requirements of IFRS 9 apply to financial assets that are measured at amortized cost or FVTOCI, and off-balance sheet lending commitments such as loan commitments and financial guarantees.

The determination of impairment losses and allowance had moved from an incurred credit loss model whereby credit losses are recognized when a defined loss event occurs under IAS 39, to an expected loss model under IFRS 9, where provisions for impairment are taken upon initial recognition of the financial asset (or the date the Bank becomes a party to the loan commitment or financial guarantee), based on expectations of potential credit losses at that time.

Under IFRS 9 for financial assets originated or purchased on initial recognition the Bank recognizes an impairment loss at an amount equal to 12-month ECL. This shall continue if the credit risk at the reporting date has not increased significantly since initial recognition; therefore, it was and shall remain in Stage 1. Such provision charge represents the ECL resulting from default events that are possible within the next 12 months.

IFRS 9 requires the recognition of credit losses over the remaining life of the financial assets ('Lifetime expected credit losses') which are considered to have experienced a significant increase in credit risk (e.g. Stage 2) and for financial assets that are credit impaired at the reporting date (e.g. Stage 3). The lifetime expected credit losses represent all possible default events over the expected life of a financial instrument. The Bank leverages existing risk management indicators (e.g. watch list and threshold trigger), credit rating changes and taking into consideration reasonable and supportable information which allows the Bank to identify whether the credit risk of financial assets has significantly increased. This process includes considering forward-looking information, including macro-economic factors. Forward-looking information, including macro-economic factors, is taken into account to measure IFRS 9 compliant expected credit losses. Furthermore, financial assets would be transferred to Stage 2 if more than 30 days past due.

Interest income is calculated on the gross carrying amount for financial assets in Stage 2. As the primary definition for credit-impaired financial assets moving to Stage 3, the Bank applies the definition of default as stated above. Interest income is calculated on the net carrying amount for these financial assets only.

Credit loss is defined as the difference between all contractual cash flows that are due in accordance with the contract and all the cash flows expected to be received (i.e. all cash shortfalls), discounted at the original effective interest rate (EIR). All contractual cash flows of the loan and cash flows resulting from the sale of collateral or other credit enhancements are considered.

According to IFRS 9, probability-weighted scenarios have to be accounted for over the expected life of the financial instrument to estimate expected losses. The assessment consists of an evaluation of a range of possible outcomes which involves identifying possible scenarios that specify the amount and timing of the cash flows for each particular outcome and the estimated probability of that particular outcome.

The Bank measures impairment losses on an individual basis. Similarly, the assessment for transferring financial assets between Stages 1, 2 and 3, are also made on an individual basis. The Bank applies three main components to measure expected credit losses which are a LGD, PD and EAD. To perform the ECL calculation, the Bank uses the Moody's Analytics IFRS ImpairmentCalc tool. Within the tool, the Bank provides probabilities of default and loss given defaults and assigns scenarios for potential

credit risk deterioration. There can be transfers of exposures from one stage to another, depending on whether there is a change in the credit risk of that exposure. Probability of default is an estimate of the likelihood of default over a given time horizon. The Bank uses information obtained from the Global Emerging Markets (GEMs) database to assign PDs to its lending asset classes. GEMs is an IFI-wide initiative designed to pool default and recovery rates experienced by IFIs in emerging markets. Treasury asset classes derive their PDs from the assigning rating agency.

Loss given default is an estimate of the loss arising on default. It is based on the difference between the contractual cash flows due and those that the Bank would expect to receive, including the cash flows from the liquidation of any collateral. The Bank uses information obtained from the GEMs database to assign LGDs to its banking asset classes. Treasury asset classes derive their LGDs from the assigning rating agency.

Exposure at default is an estimate of the exposure at a future default date, taking into account expected changes in the exposure after the reporting date, including repayments of principal and interest, and expected drawdowns on off-balance-sheet commitments.

i) Credit-impaired

A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows of that financial asset have occurred. Evidence that a financial asset is credit-impaired includes observable data about the following events:

- Significant financial difficulty of the issuer or the borrower;
- A breach of contract, such as a default or past due event;
- The lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
- It is becoming probable that the borrower will enter bankruptcy or other financial reorganization;
- The disappearance of an active market for that financial asset because of financial difficulties; or
- The purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event – instead, the combined effect of several events may have caused financial assets to become credit-impaired.

ii) Significant increase in credit risk

At each reporting date, the Bank assesses whether the credit risk on a financial instrument has increased significantly since initial recognition. When making the assessment, the Bank compares the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition and considers reasonable and supportable information, that is available without undue cost or effort, that is indicative of significant increases in credit risk since initial recognition.

Generally, there will be a significant increase in credit risk before a financial asset becomes credit-impaired or an actual default occurs. The assessment of significant increase in credit risk is key in transferring an exposure from stage 1 to stage 2 or 3 and the respective change in the ECL measurement from 12-month to lifetime ECL. A combination of quantitative and qualitative factors structured as primary and secondary drivers will be considered, and are also supplemented with backstop options. The backstop triggers automatic stage transfers even though the primary and secondary indicators may not trigger such transfer, unless this result is due to a data error, operational issues, or timing difference in applying cash received up to 30 days to the customer account.

The calculation of the present value of the estimated future cash flows of a collateralized asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

Impairment losses for guarantees are recognized while a guarantee is in effect and the amounts are determined based on the level of utilization of the guarantee. The methodology is consistent to that of loan commitments, and such losses are included in 'Other liabilities'.

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

b) Non-financial assets

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

c) Renegotiated financial assets

When necessary, the Bank seeks to restructure a financial asset that may involve extending the payment arrangements and the agreement of new loan conditions. These are generally renegotiated in response to an adverse change in the borrower's financial conditions.

Modifications occur when the contractual cash flows of a financial asset are renegotiated or otherwise modified. Some modifications result in derecognition of the existing asset and recognition of a new asset, while other modifications do not result in derecognition. Modifications that result in derecognition are considered to be substantial modifications. A significant or substantial change is defined when the customer enters into a new loan contract (i.e. completely new product and new pricing) that has a different interest rate type, loan amount, term period (temporary term extension is excluded), and/or client (e.g. from single client to joint or change in one of the joint client names).

A distressed restructuring indicates an unlikeliness to pay where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement of principal interest or, where relevant, fees. Distressed restructuring occurs when forbearance measures have been extended towards a debtor. Therefore, those forborne exposures where the forbearance measures are likely to result in a diminished financial obligation are classified as defaulted.

Restructured operations will be considered cured and normalized after 2 successful repayments and could therefore be subject to a stage movement.

d) Write-offs

According to the IFRS 9 (B5.4.9), the gross carrying amount of a financial asset may be directly reduced when there is no reasonable expectation of recovering the financial asset in its entirety or a portion of it. As such, the Bank may record a write-off of Stage 3 loans. The Bank may also, on an ad-hoc basis, examine the need for any further write-offs of Stage 2 loans if there is relevant evidence.

Financial Guarantees

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

Property and Equipment

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

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

Intangible Assets

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

Taxation

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

Provisions

The Bank records 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 obligation amount can be made.

Share Capital and Dividends

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

Reserves and Retained Earnings

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

The revaluation reserve represents the accumulated change in fair value of those financial assets that are measured at fair value through other comprehensive income of the Bank.

The Bank's retained earnings are the accumulated undistributed and unallocated net income over the years.

Income and Expenses

Interest income and expense are recorded in income for all interest bearing instruments on an accrual basis using the effective interest rate method based on actual contractual terms. The exception is those assets that are individually identified as impaired for which interest is recognized through unwinding

the discount arising from the present value calculations applied to the expected future cash flows. The effective interest rate method is a method of calculating the amortized cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash flows (inflows and outflows) through the expected life of the financial instrument, or when appropriate, a shorter period to the carrying amount of a financial asset or financial liability.

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

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

Staff Retirement and Termination Benefits

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

- The first pillar is a defined benefit scheme financed entirely by the Bank. The scheme's funding level and the Bank's contributions are determined on the basis of actuarial valuations performed annually by qualified, independent actuaries. The Bank is under the obligation to maintain the scheme fully funded and, to this effect, has always liquidated any past service deficit in the course of the year following the relevant actuarial valuation. Actuarial and asset gains or losses are recognized in 'Other comprehensive income', and net gains or losses are included in remeasurements where any change in the effect of the asset ceiling, excluding those amounts that have been already included in personnel expenses, are also included.
- The second pillar is a defined contribution scheme to which both the employee and the Bank contribute equally at a rate of 0–12% of basic salary. Each employee determines his/her contribution rate and the contributions' mode of investment.
- The third pillar is a defined contribution scheme funded entirely by each employee, up to 40% of basic salary.

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

Current service costs for both the pension plan and IKA are recognized as an expense and included in 'Personnel expenses'.

The Bank may offer termination benefits to employees that are separated based on the Bank's separation policy. These benefits, including indemnities and any related retirement benefits, are recognized in income as an expense in the same period they are incurred.

Government Grants

Government grants are recognized where there is reasonable assurance that the grant will be received and all attaching conditions will be complied with. Grants relating to fixed asset expenditures are recognized in income on a straight-line basis over the same period as that applied for depreciation purposes. Those relating to administrative expenses are recognized in income matching with the expense incurred.

Operating Leases – the Bank as a Lessee

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

New and Forthcoming Accounting Standards

The Bank, consistent with the published financial statements concerning the fiscal year ending on 31 December 2016, after taking into account the following amendments to the standards which were issued by the International Accounting Standards Board (IASB), adopted by the European Union and applied on and after 1 January 2017:

- Amendment to International Accounting Standard 7 'Statement of Cash Flows': Disclosure Initiative (effective for annual periods beginning on or after 1 January 2017)

  On 29 January 2016, the International Accounting Standards Board issued an amendment to IAS 7 according to which an entity shall provide disclosures that enable users of financial statements to evaluate changes in liabilities for which cash flows are classified in the statement of cash flows as cash flows from financing activities. The changes that shall be disclosed, which may arise both from cash flows and non-cash changes, include:

  - Changes from financing cash flows;
  - Changes arising from obtaining or losing control of subsidiaries or other businesses;
  - The effect of changes in foreign exchange rates;
  - Changes in fair values; and
  - Other changes.

  The above amendment has no impact on the Bank's Financial Statements.

- Amendment to International Accounting Standard 12 'Income Taxes': Recognition of Deferred Tax Assets for Unrealized Losses (effective for annual periods beginning on or after 1 January 2017)

  On 19 January 2016, the International Accounting Standards Board issued an amendment to IAS 12 with which the following were clarified:

  - Unrealized losses on debt instruments measured at fair value for accounting purposes and at cost for tax purposes may give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the asset by sale or by use.
  - The recoverability of a deferred tax asset is assessed in combination with other deferred tax assets. However, if tax law offsets specific types of losses only against a particular type of income, the relative deferred tax asset shall be assessed in combination with other deferred tax assets of the same type.
  - During the deferred tax asset recoverability assessment, an entity compares the deductible temporary differences with future taxable profit that excludes tax deductions resulting from the reversal of those deductible temporary differences.
  - The estimate of probable future taxable profit may include the recovery of some of an entity's assets for more than their carrying amount if there is sufficient evidence that it is probable that the entity will achieve this.

  The above amendment has no impact on the Bank's Financial Statements.

- **Improvements to the International Accounting Standards – cycle 2012–2014** (Regulation 2015/2343/15.12.2015).

  As part of the annual improvement project of the International Accounting Standards, the Board issued, on 25.09.2014, non-urgent but necessary amendments to various standards.

  The adoption of the above amendments by the Bank had no impact on its financial statements.

- **International Financial Reporting Standard 9:** 'Financial Instruments' (Regulation 2017/2395/27.12.2017), (effective for annual periods beginning on or after 1 January 2018)

  In July 2014, the International Accounting Standards Board issued the final version of IFRS 9: 'Financial Instruments' for financial years beginning on or after 1 January 2018, with early application. The Bank has decided to proceed to the early application of the Standard on the financial statements as of 31 December 2017. This Standard replaces IAS 39 'Financial Instruments: Recognition and Measurement'.

Classification and measurement

Under the new framework (International Financial Reporting Standard - IFRS 9), the classification of assets defines how existing information is reflected in the financial statements. In particular, the valuation method and the impairment calculation are defined by this classification, which should be based on criteria established by the Bank.

Procedure for classifying financial assets

The Bank recognizes a financial asset or liability in its financial statements at the time of the creation of the contractual claim or liability arising from the item (that is, the day the transaction took place). In recognition, the Bank determines the business model to which it belongs.

The financial assets are classified in three categories:

- *Financial assets measured at amortized cost (AC):* This category classifies each asset or bank of assets for which the Bank's business model constitutes its holding for the purpose of collecting contractual cash. The possible sale of financial assets should not be the result of business planning for their management.
- *Financial assets measured at Fair Value through Other Comprehensive Income (FVOCI), that are reclassified at Fair Value through Income Statement on derecognition:* Profits or losses arising from the measurement are recorded in a separate equity account. This category classifies each asset or bank of assets for which the Bank's business model recommends that it be held for the purpose of collecting contractual cash flows and selling them when the strategic planning of their acquisition has been achieved.

To classify assets in the above categories, contractual cash flows should consist solely of payments of principal and interest (SPPIs).

- *Financial assets measured at FVTPL: This category classifies items that do not meet the SPPI criterion as well as the items that the Bank holds for trading.*

Their classification depends primarily on the following two important factors:

- The Bank's business model for these assets.
- The characteristics of the contractual cash flows of the asset.

Measurement of financial assets

The Bank measures its assets at fair value on initial recognition. Assets classified at fair value through profit or loss are valued at their transaction price. Assets classified at amortized cost, any transaction costs or creation costs are included in their transaction price at their measurement. In the event the Bank considers that the fair value on initial recognition, differs from the transaction price, the difference is recognized as a gain or loss on initial recognition, but only if the fair value is

based on a requested active market price for identical assets or is based on a valuation technique using data solely from identified markets. In all other cases the fair value is adjusted to the amount of the transaction price.

Business model assessment

The factor of the business model refers amongst others to the manner in which the Bank manages its financial assets by classifying them in portfolios that are part of its business model.

The assessment process applied by the Bank through its business model, based on strategic objectives, classifies its assets in the following three categories in accordance with IFRS 9:

- Hold to collect:

  Each asset or bank of assets for which the Bank's business model recommends that it be held for the purpose of collecting contractual cash flows is classified as 'Hold to collect'.

- Hold to collect and sell:

  Each asset or bank of assets for which the Bank's business model recommends that it be held for the purpose of collecting contractual cash flows and selling them when the strategic planning of their acquisition has been achieved is classified as 'Hold to collect and sell'.

- Trading portfolio:

  The financial assets held for trading are classified as 'Trading portfolio'.

The adopted business model determines the source of revenue as it arises from individual porfolios, either through the collection of contractual cash flows or from the sale of financial assets or a combination of the two.

The assessment of the business model reflects the Bank's strategy under normal business conditions. The assessment is not affected by actions required in 'emergency situations' (e.g. liquidity needs, non-inherent capital requirements for credit risk, etc.). Also, Management decisions taken to comply with new regulatory guidelines are not included in the assessment.

In general, the Bank has included the majority of its loan portfolios in the 'hold-to-collect' business model. The assessment of a business model is made within the definition of operational objectives as defined by the Bank's Management, as well as in the operational management of its assets. The assessment is effected at portfolio level rather than individual assets.

Assessment of the SPPI condition (assessment of contractual cash flows solely in capital and interest payments)

In 2017, the Bank conducted an assessment of the business model applied to the portfolios and carried out a detailed assessment of the contractual terms in the debt securities portfolio on a sample basis, carrying on to cover the entire portfolio, to identify possible changes in their classification and measurement. For the most part, the Bank's debt portfolio complies with the 'SPPI' condition. Consequently, based on the existing business models as at 31 December 2017, the Bank expects that in general:

- Due from banks and loans and advances to customers that are measured at amortized cost in accordance with IAS 39 will continue to be measured at amortized cost in accordance with IFRS 9;
- Held-to-maturity investment securities that are measured at amortized cost in accordance with IAS 39 will be classified as measured at amortized cost in accordance with IFRS 9;
- Bonds that are classified as available-for-sale in accordance with IAS 39 will be classified according to their business model at their fair value through other comprehensive income directly in equity;
- Debt securities that, according to IAS 39 are measured at amortized cost, will be classified as either measured at amortized cost or at fair value through other comprehensive income directly in equity, depending on their business model;

- Bond that under IAS 39 are measured at fair value through profit or loss, will continue to be measured at fair value through profit or loss in accordance with IFRS 9;
- Trading bonds and derivative financial assets that, according to IAS 39, are measured at fair value through profit or loss, will be classified as measured at fair value through profit or loss in accordance with IFRS 9; and
- Shares that are classified as available-for-sale in accordance with IAS 39 will be measured at fair value through other comprehensive income directly in equity, unless elected at fair value through profit or loss in accordance with IFRS 9.

Impairment of financial assets

IFRS 9 provides that impairment of financial assets will occur regardless of whether a loss event has already occurred. Therefore, all financial assets measured at amortized cost will be tested to determine whether their credit quality has changed significantly since the date of their creation. The audit will result in the classification of the data in 3 stages, which in ascending order will indicate the credit risk, and corresponding provisioning charge, of each item.

In this way, stage 1 includes assets whose credit quality is not significantly degraded and the impairment that they will incur will be equal to a 12-month ECL. Stage 2 includes assets whose credit quality has been substantially downgraded. These assets are subject to lifetime ECL. The same applies to the items classified in Stage 3, where all the impaired items, including non-performing loans (NPLs), fall.

Calculation of Expected Credit Loss

The measurement of expected credit losses differs from their previous calculation under IAS 39, given that the assets classified in Stages 2 and 3 take into account their overall life span. Moreover, the expected credit losses will be weighted on the basis of three macroeconomic scenarios (adverse, basic and favorable). Consequently, measurement requires using complex models and assumptions about macroeconomic conditions. For this reason, the Bank has acquired an IT system from a qualified provider.

Classification of loans into stages based on credit risk (Staging)

The Bank has introduced a number of criteria classifying financial assets in stages. These criteria are intended to check whether there has been a significant deterioration in the credit quality of financial assets since their creation. Essentially, the Bank examines:

- Days past due;
- If there has been a significant downgrade of assets' credit rating; and
- Qualitative parameters indicating a change in credit quality (e.g. dealing with financial difficulties).

Basic parameters for the calculation of expected credit loss

The calculation of expected credit losses is based on the probability of default (PD), loss given default (LGD), exposure at default (EAD) and other parameters such as the credit conversion factor (CCF) and the prepayment rate.

The Bank has obtained from an external provider a system of calculating expected credit losses. The basic parameters have been drawn from statistical models developed in cooperation with the external provider, utilizing the existing risk management infrastructure and practices of the Bank and the know-how and experience of the provider.

Probability of Default (PD) represents the probability that a debtor will default on his debt obligations either over the next twelve months or over the remaining maturity of his debt. In accordance with IFRS 9, the Bank uses non-discriminatory point-in-time PDs that adjust to macroeconomic assumptions using the ECL.

Exposure at Default (EAD) is defined as the estimate of the exposure in the event of a default of the debtor. The EAD of a financial asset represents its gross carrying amount in the event of a default.

Loss Given Default (LGD) represents the extent of the loss that the Bank expects for exposures that are in default and is defined as the difference between the contractual cash flows and those that the Bank expects to collect, including collateral amounts. LGD, which is usually expressed as a percentage of the EAD, varies according to the category of the counterparty, the category and priority of the claim, the existence of collateral and other credit enhancements.

Credit Conversion Factor (CCF) is used to convert credit lines and other off-balance sheet exposures into EAD amounts. It is considered as an assumption representing the percentage of undrawn exposures expected to be disbursed prior to the occurrence of the default event. The prepayment rate is an estimate of premature repayments of a financial exposure that exceeds contractual repayments on the basis of the repayment schedule and is expressed as a percentage of the EAD in each reporting period resulting in a reduction in the EAD.

The Bank has made use of three macroeconomic scenarios (basic, adverse and favorable) taking into account the relative chances of each scenario. The baseline scenario is the most likely scenario and is in line with the Bank's information for strategic planning and budgeting purposes.

Hedge Accounting

IFRS 9 introduces a new general hedge accounting model, which links hedge accounting to risk management activities by the Management. According to the new model, additional hedging strategies may meet the hedge accounting criteria, new requirements apply to the effectiveness of hedging, while terminating hedge accounting will be permissible only under certain conditions. The International Accounting Standards Board for macro-hedging accounting is carrying out a separate work that is in progress. Until such work is completed as an accounting policy, entities may continue to apply the requirements of IAS 39 for hedge accounting.

- **International Financial Reporting Standard 15** 'Revenue from Contracts with Customers' (Regulation 2016/1905/22.9.2016), (effective for annual periods beginning on or after 1 January 2018)

IFRS 15 'Revenue from Contracts with Customers' was issued on 28.5.2014 by the International Accounting Standards Board. The new standard is the outcome of a joint project by the IASB and the Financial Accounting Standards Board (FASB) to develop common requirements as far as the revenue recognition principles are concerned.

The new standard shall be applied to all contracts with customers, except those in the scope of other standards, such as financial leases, insurance contracts and financial instruments.

According to the new standard, an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. A new revenue recognition model is introduced, by applying the following five steps:

- Step 1: Identify the contract(s) with a customer.
- Step 2: Identify the performance obligations in the contract.
- Step 3: Determine the transaction price.
- Step 4: Allocate the transaction price to the performance obligations in the contract.
- Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The performance obligation notion is new and, in effect, represents a promise in a contract with a customer to transfer to the customer either: (a) a good or service (or a bundle of goods or services) that is distinct; or (b) a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

The new IFRS 15 supersedes:

- IAS 11 'Construction Contracts';
- IAS 18 'Revenue';
- IFRIC 13 'Customer Loyalty Programs';
- IFRIC 15 'Agreements for the Construction of Real Estate';
- IFRIC 18 'Transfers of Assets from Customers'; and
- SIC-31 'Revenue—Barter Transactions Involving Advertising Services'.

The Bank anticipates no material impact as a result of adopting IFRS 15.

In addition, the International Accounting Standards Board has issued the following standards and amendments to standards as well as IFRIC 22 which have not yet been adopted by the European Union and they have not been applied early by the Bank.

- **Amendment to International Financial Reporting Standard 2** 'Share-based Payment': Classification and Measurement of Share-based Payment Transactions (effective for annual periods beginning on or after 1 January 2018)

  On 20.6.2016 the International Accounting Standards Board issued an amendment to IFRS 2 in which the following were clarified:

  - In estimating the fair value of a cash-settled share-based payment, the accounting for the effects of vesting and non-vesting conditions shall follow the same approach as for equity-settled share-based payments.
  - Where tax law requires an entity to withhold a specified amount of tax (that constitutes a tax obligation of the employee) that relates to share-based payments and shall be remitted to the tax authority, such an arrangement shall be classified as equity-settled in its entirety, provided that the share-based payment would have been classified as equity-settled had it not included the net settlement feature.
  - If the terms and conditions of a cash-settled share-based payment transaction are modified with the result that it becomes an equity-settled share-based payment transaction, the transaction is accounted for as such from the modification date.

  The Bank is examining the impact on its financial statements from adopting the above amendment.

- **Amendment to International Financial Reporting Standard 4** 'Insurance Contracts': applying IFRS 9 **Financial Instruments** with IFRS 4 Insurance Contracts (effective for annual periods beginning on or after 1 January 2018)

  On 12.9.2016 the International Accounting Standards Board issued an amendment to IFRS 4 in which:

  - It provides insurers, whose activities are predominantly connected with insurance, with a temporary exemption from application of IFRS 9; and
  - Following full adoption of IFRS 9, it gives all entities with insurance contracts the option to present changes in fair value on qualifying designated financial assets in other comprehensive income instead of profit or loss.

  The above amendment has no impact on the Bank's Financial Statements.

- **Amendment to International Financial Reporting Standard 10** 'Consolidated Financial Statements' and **to International Accounting Standard 28** 'Investments in Associates and Joint Ventures': Sale or contribution of assets between an investor and its associate or joint venture (effective date: to be determined)

  On 11.9.2014 the International Accounting Standards Board issued an amendment to IFRS 10 and IAS 28 to clarify the accounting treatment of a transaction of sale or contribution of assets between an investor and its associate or joint venture. In particular, IFRS 10 was amended to clarify that in case, as a result of a transaction with an associate or joint venture, a parent loses control of

a subsidiary, which does not contain a business, as defined in IFRS 3, it shall recognize to profit or loss only the part of the gain or loss which is related to the unrelated investor's interests in that associate or joint venture. The remaining part of the gain from the transaction shall be eliminated against the carrying amount of the investment in that associate or joint venture. In addition, in case the investor retains an investment in the former subsidiary and the former subsidiary is now an associate or joint venture, it recognizes the part of the gain or loss resulting from the re-measurement at fair value of the investment retained in that former subsidiary in its profit or loss only to the extent of the unrelated investor's interests in the new associate or joint venture. The remaining part of the gain is eliminated against the carrying amount of the investment retained in the former subsidiary.

In IAS 28, respectively, it was clarified that the partial recognition of the gains or losses shall be applied only when the involved assets do not constitute a business. Otherwise, the total of the gain or loss shall be recognized.

On 17.12.2015, the International Accounting Standards Board deferred the effective date for the application of the amendment that had been initially determined. The new effective date will be determined by the International Accounting Standards Board at a future date after taking into account the results of its project relating to the equity method.

The above amendment has no impact on the Bank's Financial Statements.

- International Financial Reporting Standard 14 'Regulatory deferral accounts'

  On 30.1.2014 the International Accounting Standards Board issued IFRS 14. The new standard addresses the accounting treatment and the disclosures required for regulatory deferral accounts that are maintained in accordance with local legislation when an entity provides rate-regulated goods or services. The scope of this standard is limited to first-time adopters that recognized regulatory deferral accounts in their financial statements in accordance with their previous GAAP. IFRS 14 permits these entities to capitalize expenditure that non-rate regulated entities would recognize as expense.

  The above standard does not apply to the financial statements of the Bank.

- Amendment to International Financial Reporting Standard 15 'Revenue from Contracts with Customers': Clarifications to IFRS 15 Revenue from Contracts with Customers (effective for annual periods beginning on or after 1 January 2018)

  On 12.4.2016 the International Accounting Standards Board issued an amendment to IFRS 15 with which it clarified mainly the following:

  - When a promised good or service is separately identifiable from other promises in a contract, which is part of an entity's assessment of whether a promised good or service is a performance obligation;
  - How to apply the principal versus agent application guidance to determine whether the nature of an entity's promise is to provide a promised good or service itself (i.e. the entity is a principal) or to arrange for goods or services to be provided by another party (i.e. the entity is an agent); and
  - For a license of intellectual property, that is a factor in determining whether the entity recognizes revenue over time or at a point in time.

  Finally, two practical expedients to the transition requirements of IFRS 15 were added for completed contracts under full retrospective transition approach as well as for contract modifications at transition.

  The Bank anticipates no material impact as a result of adopting IFRS 15.

- Annual improvements to IFRSs – Cycle 2014–2016 (effective for annual periods beginning on or after 1 January 2017 and 1 January 2018)

  In December 2016, IASB issued the 'Annual Improvements to IFRS - Cycle 2014–2016', which consists of a series of amendments to some Standards and is part of the program for annual improvements to IFRSs. The amendments included in this cycle are as follows: IFRS 12: Clarification

of the Scope of the Standard, IFRS 1: Deletion of short-term exemptions for first-time adopters, IAS 28: Measurement of an associate or a joint venture at fair value. The amendments are effective for annual periods beginning on or after 1 January 2017 with respect to IFRS 12 and on or after 1 January 2018 with respect to IFRS 1 and IAS 28. These amendments are not expected to have any material effect on the Financial Statements of the Bank. The above have not been adopted by the European Union.

- **Amendment to IFRS 2: 'Share-based Payment: Classification and Measurement of Share-based Payment Transactions'** (effective for annual periods on or after 1 January 2018)

  In June 2016, IASB issued a limited-purpose amendment to IFRS 2. The purpose of this amendment is to provide clarification on the accounting treatment of specific types of equity-based payment transactions. In particular, the amendment introduces the requirements regarding the accounting treatment of the effect of vesting and non-vesting conditions on the measurement of cash-based equity-settled payments, the accounting treatment of equity-settled payment transactions bearing a settlement characteristic in a deduction basis for a withholding tax, and an amendment to the terms and conditions of an equity-linked payment which changes the classification of the transaction from cash settled to equity-settled. These amendments are not expected to have any material effect on the Bank's financial statements. The above have not been adopted by the European Union.

- **Amendment to International Accounting Standard 40 'Investment Property: Transfers of Investment Property'** (effective for annual periods on or after 1 January 2018)

  In December 2016, IASB issued limited scoping changes to IAS 40. The purpose of these amendments is to strengthen the principle of transfers from or to investment property to determine that (a) a transfer from, or investment in, real estate should only take place if there is a change in the use of the property, (b) such a change in the use of the property would include the assessment of the amount by which the property in question meets the criteria for classification as an investment property. Such change in use should be supported by relevant documentation / evidence. These amendments are not expected to have any material effect on the Bank's Financial Statements. The above have not been adopted by the European Union.

- **IFRIC 22 'Foreign Currency Transactions and Advance Consideration'** (effective for annual periods on or after 1 January 2018)

  In December 2016, IASB issued a new IFRIC 22 Interpretation. This Interpretation includes the exchange rate requirements to be used when presenting foreign currency transactions (e.g. revenue transactions) when payment has been received or paid in advance. These amendments are not expected to have any material effect on the Bank's Financial Statements. The above have not been adopted by the European Union.

- **Amendment to International Accounting Standard 28: 'Investments in Associates'** (effective for annual periods on or after 1 January 2019)

  In October 2017, the IASB issued limited-purpose amendments to IAS 28. The purpose of these amendments is to provide clarifications on the accounting treatment of long-term participations in an associate or joint venture - to which the equity method does not apply - based on IFRS 9. These amendments are not expected to have any material effect on the Bank's Financial Statements. The above have not been adopted by the European Union.

- **Annual Improvements to IFRSs – Cycle 2015–2017** (effective for annual periods beginning on or after 1 January 2019)

  In December 2017, IASB issued the 'Annual Improvements to IFRSs - Cycle 2015–2017', which consists of a series of amendments to certain Standards and is part of the annual improvements program for IFRS. The amendments included in this cycle are as follows: IFRS 3 - IFRS 11: Participation rights previously held by the acquirer in a joint venture, IAS 12: Effect on income tax on payments for financial instruments classified as equity, IAS 23: Borrowing costs eligible for capitalization. The amendments shall be applied for annual periods beginning on or after 1 January 2019. The Bank will examine the impact of all of the above in its Financial Statements, although it is not expected that any impacts will arise. The above have not been adopted by the European Union.

- **International Financial Reporting Standard 16 'Leases'** (effective for annual periods beginning on or after 1 January 2019)

  On 13.1.2016 the International Accounting Standards Board issued IFRS 16 'Leases' which supersedes:

  - IAS 17 ' Leases';
  - IFRIC 4 'Determining whether an arrangement contains a lease';
  - SIC 15 'Operating Leases – Incentives'; and
  - SIC 27 'Evaluating the substance of transactions involving the legal form of a lease'.

  The new standard significantly differentiates the accounting of leases for lessees while essentially maintaining the existing requirements of IAS 17 for the lessors. In particular, under the new requirements, the classification of leases as either operating or finance is eliminated. A lessee is required to recognize, for all leases with a term of more than 12 months, the right-of-use asset as well as the corresponding obligation to pay the lease payments. The above treatment is not required when the asset is of low value.

  The Bank is examining the impact on its financial statements of adopting IFRS 16.

- **IFRIC 23 'Uncertainty over Income Tax Treatments** (effective for annual periods beginning on or after 1 January 2019)

  In June 2017, the IASB issued a new IFRIC 23 Interpretation. IAS 12 'Income Taxes' specifies the accounting treatment of current and deferred tax, but does not specify how uncertainty effects should be reflected. IFRIC 23 includes the IAS 12 requirements, specifying how the effects of the uncertainty on the accounting treatment of income taxes should be reflected. The Bank will examine the impact of all of the above in its Financial Statements, although it is not expected that any impacts will arise. The above have not been adopted by the European Union.

- **IFRS 17 'Insurance Contracts'** (effective for annual periods beginning on or after 1 January 2021)

  In May 2017, the IASB issued a new Standard, IFRS 17, which replaces an interim standard, IFRS 4. The IASB's aim was to develop a single principle-based Standard for the accounting treatment of all types of insurance contracts, including reinsurance contracts held by an insurer. A single principle-based standard will enhance the comparability of the financial reporting between economic entities, jurisdictions and capital markets. IFRS 17 specifies the requirements that an entity should apply to financial reporting that is related to insurance contracts it issues and reinsurance contracts it holds. The Bank will examine the impact of all of the above in its Financial Statements, although it is not expected that any impacts will arise.

4. USE OF ESTIMATES

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

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

- Provisions for the impairment of loan operations. The Bank's method for determining the level of impairment of loan operations is described in the 'impairment' accounting policy and further explained in the relevant risk management policies of this document. Provisions for loans that have an expected credit loss of 12-month amounted to EUR 1,453 thousand and those loans that have an expected lifetime credit loss but that are not credit impaired amounted to EUR 1,088 thousand.

In determining the above provision amounts the Bank takes into consideration PD and LGD factors extracted from the GEMs database.

Furthermore, those loans that have an expected lifetime credit loss and are credit impaired amounted to EUR 45,455 thousand. These provisions are assigned according to the degree of potential impairment resulting from the impairment test that is conducted on the basis of objective evidence obtained through a risk asset review process.

An impairment test includes projected cash in-flows and out-flows, available for debt service until maturity, which are discounted at the effective interest rate to reach a net present value for a particular operation, less any collateral that can be realized.

- Staff retirement benefits. The Bank has established a pension plan for its staff which is described in 'staff retirement and termination benefits' accounting policy and is detailed under staff retirement plan in 'Employee benefits'. The present value of retirement benefit obligations is sensitive to the actuarial and financial assumptions used, including the discount rate applied. At the end of each year, the Bank determines the appropriate discount rate and other assumptions to be used to determine the present value of estimated future pension obligations, based on interest rates of suitable long-term bonds and on currencies such as the EUR and USD. The Bank's liability to the staff retirement plan at the financial position date was EUR 5,232 thousand.

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

5. RISK MANAGEMENT

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

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

Financial Risk

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

a) Credit risk

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

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

For credit risks incurred by the Bank's Treasury in its investment and hedging activities, the Board of Directors has approved policies and guidelines for the determination of counterparty and investment

exposure limits. The Bank's Risk Management Department assigns and monitors these counterparty and issuer credit risk limits. Treasury credit risks are also reviewed on a monthly basis by the Bank's Asset and Liability Committee.

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

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Cash and bank balances	81,481	70,034
Debt investment securities	292,524	414,539
Derivative financial instruments	1,659	576
Loans	1,135,081	1,139,072
Other assets	26,157	25,652
On-balance-sheet	**1,536,902**	**1,649,873**
Undrawn commitments	185,563	160,191
Total	**1,722,465**	**1,810,064**

b) Analysis by rating agency

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

	2017				
Presented in EUR (000)	Aaa – Aa3	A1 – A3	Baa1 – Ba3	Unrated	**Total**
Analysis by Moody's rating					
Cash and bank balances	81,481	-	-	-	**81,481**
Debt investment securities	28,420	144,957	119,147	-	**292,524**
Equity investments	-	-	-	31,361	**31,361**
At 31 December	**109,901**	**144,957**	**119,147**	**31,361**	**405,366**
Of which issued by					
Governments	-	11,632	41,473	-	**53,105**
Corporates	28,420	133,325	77,674	31,361	**270,780**
Cash deposits at banks	81,481	-		-	**81,481**
At 31 December	**109,901**	**144,957**	**119,147**	**31,361**	**405,366**
Of which classified as					
Fair value through profit or loss	-	-	-	1,600	**1,600**
Fair value through other comprehensive income	28,420	144,957	119,147	29,761	**322,285**
Amortized cost	81,481	-	-	-	**81,481**
At 31 December	**109,901**	**144,957**	**119,147**	**31,361**	**405,366**

Presented in EUR (000)	2016				
	Aaa – Aa3	A1 – A3	Baa1 – Ba3	Unrated	**Total**
Analysis by Moody's rating					
Cash and bank balances	70,034	-	-	-	**70,034**
Debt investment securities	28,542	226,374	159,623	-	**414,539**
Equity investments	-	-	-	52,766	**52,766**
At 31 December	**98,576**	**226,374**	**159,623**	**52,766**	**537,339**
Of which issued by					
Governments	-	15,283	24,156	-	**39,439**
Corporates	28,542	211,091	135,467	52,766	**427,866**
Cash deposits at banks	70,034	-	-	-	**70,034**
At 31 December	**98,576**	**226,374**	**159,623**	**52,766**	**537,339**
Of which classified as					
Available-for-sale	28,542	226,374	159,623	52,766	**467,305**
Held-to-maturity	-	-	-	-	**-**
Amortized cost	70,034	-	-	-	**70,034**
At 31 December	**98,576**	**226,374**	**159,623**	**52,766**	**537,339**

The following table shows the new measurement categories in accordance with IFRS 9 for the Bank's financial instruments as at 1 January 2017.

Presented in EUR (000)	2017				
	Aaa – Aa3	A1 – A3	Baa1 – Ba3	Unrated	**Total**
Of which classified as					
Fair value through profit or loss	-	-	-	5,162	**5,162**
Fair value through other comprehensive income	28,542	226,374	159,623	47,604	**462,143**
Amortized cost	70,034	-	-	-	**70,034**
At 1 January	**98,576**	**226,374**	**159,623**	**52,766**	**537,339**

c) Credit risk analysis

The tables below provide an analysis of the Bank's internal expected credit loss rating scale from 1 (lowest risk) to 15 (highest risk) and how it corresponds to the external ratings of Moody's credit rating service.

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

c1. Credit risk in loans portfolio

The table provides an overview of the exposure amount and allowance for credit losses by financial asset class broken down into stages as per IFRS 9 requirements.

	Presented in EUR (000)							
					Provisions for impairment			
Internal risk rating category	12-month ECL	Lifetime ECL not credit impaired	Lifetime ECL credit Impaired	**Total**	12-month ECL	Lifetime ECL not credit impaired	Lifetime ECL credit impaired	**Total**
Excellent	-	-	-	**-**	-	-	-	**-**
Very strong	-	-	-	**-**	-	-	-	**-**
Strong	-	-	-	**-**	-	-	-	**-**
Good	9,739	-	-	**9,739**	1	-	-	**1**
Fair	646,611	-	-	**646,611**	608	-	-	**608**
Weak	339,240	36,481	-	**375,721**	823	833	-	**1,656**
Special attention	-	39,142	51,982	**91,124**	21	255	36,291	**36,567**
Expected loss	-	-	9,164	**9,164**	-	-	9,164	**9,164**
At 31 December 2017	**995,590**	**75,623**	**61,146**	**1,132,359**	**1,453**	**1,088**	**45,455**	**47,996**

The table provides an overview of the exposure amount and allowance for credit losses by financial asset class broken down as per IAS 39 requirements. Loans that are neither past due nor impaired are categorized as standard within collective impairment, and those loans that are individually identified as impaired are categorized within specific impairment.

	Presented in EUR (000)						
Internal risk rating category	Neither past due nor impaired	Past due but not impaired	Impaired	**Total**	Collective provisions for impairment	Specific provisions for impairment	**Total**
Excellent	-	-	-	**-**	-	-	**-**
Very strong	-	-	-	**-**	-	-	**-**
Strong	-	-	-	**-**	-	-	**-**
Good	125,798	-	-	**125,798**	996	-	**996**
Fair	452,960	-	-	**452,960**	3,587	-	**3,587**
Weak	457,616	-	-	**457,616**	3,624	-	**3,624**
Special attention	26,474	3,558	33,511	**63,543**	238	6,376	**6,614**
Expected loss	-	-	39,155	**39,155**	-	15,310	**15,310**
At 31 December 2016	**1,062,848**	**3,558**	**72,666**	**1,139,072**	**8,445**	**21,686**	**30,131**

d) Collateral and credit enhancements

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

- Loans and advances. The Board of Directors approved guidelines for taking security under lending operations, and set the levels and types of collateral and other credit enhancements recommended for a given risk profile.

  The main types of collateral the Bank may obtain 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. If necessary, the Bank reassesses the value of collateral to determine if the borrower needs to provide additional collateral. As at 31 December 2017 the secured portfolio was 57.9% (2016: 65.7%) of the outstanding loans balance.

- Other financial instruments. Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Bonds and ECP held by the Bank as investment securities are generally unsecured. The Bank may hold cash or government securities as collateral against its derivative contract counterparties. At 31 December 2017 the Bank had pledged cash collateral in an amount of EUR 17,670 thousand (2016: EUR 36,950 thousand).

e) Liquidity risk

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

The Bank takes into consideration, to the extent feasible, the guidance documents issued by the Basel Committee on Banking Supervision. The Bank sets limits to control its liquidity risk exposure and vulnerabilities and regularly reviews such limits. The limit framework includes measures ensuring that in a period of market stress, available liquidity exceeds liquidity needs and that the Bank can continue to operate.

The Bank's commitment to maintaining a strong liquidity position is established in policies, approved by the Board of Directors, including a minimum liquidity ratio of 50% of the Bank's net cash requirements over the next 12 months on a rolling basis. The Bank's liquid assets are maintained in short-term placements and negotiable securities.

The table below presents the cash flows payable on financial liabilities placed into relevant maturity groups, based on the remaining period from the financial position date to the contractual maturity date. It indicates the earliest maturity dates that the Bank's counterparties have the ability to demand repayment.

The figures represent undiscounted cash flows, and include estimated interest amounts, and therefore do not match to the statement of financial position.

Presented in EUR (000)	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Total
Borrowings	601	2,482	68,552	730,352	11,199	**813,186**
Derivative financial instruments	-	18,242	-	-	-	**18,242**
Payables and accrued interest	-	10,190	5,232	-	-	**15,422**
Financial Liabilities at 31 December 2017	**601**	**30,914**	**73,784**	**730,352**	**11,199**	**846,850**
Borrowings	685	1,906	77,094	902,696	39,411	1,021,792
Derivative financial instruments	-	35,100	-	-	-	35,100
Payables and accrued interest	-	10,920	4,648	-	-	15,568
Financial Liabilities at 31 December 2016	**685**	**47,926**	**81,742**	**902,696**	**39,411**	**1,072,460**

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

Market Risk

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

a) Foreign exchange risk

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

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

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

Presented in EUR (000)	Euro	United States dollar	Swiss franc	Other	**Total**
Assets					
Cash and bank balances	69,084	12,034	-	363	**81,481**
Debt investment securities	135,077	157,447	-	-	**292,524**
Impairment losses on debt investment securities	(127)	(149)	-	-	**(276)**
Derivatives financial instruments	1,659	-	-	-	**1,659**
Loans	595,412	487,161	-	52,508	**1,135,081**
Deferred income	(2,567)	(3,280)	-	(372)	**(6,219)**
Impairment losses on loans	(26,358)	(21,222)	-	(416)	**(47,996)**
Equity investments	16,682	14,679	-	-	**31,361**
Other assets	13,004	11,589	222	1,342	**26,157**
Total	801,866	658,259	222	53,425	**1,513,772**
Liabilities					
Borrowings	76,756	500,214	85,667	59,955	**722,592**
Derivative financial instruments	18,242	-	-	-	**18,242**
Payables and accrued interest	7,197	7,073	52	1,100	**15,422**
Total	102,195	507,287	85,719	61,055	**756,256**
Net financial instruments	699,671	150,972	(85,497)	(7,630)	**757,516**
Derivative financial instruments	75,757	(155,250)	85,455	7,485	**13,447**
Currency balance at 31 December 2017	**775,428**	**(4,278)**	**(42)**	**(145)**	**770,963**

Presented in EUR (000)	Euro	United States dollar	Swiss franc	Other	**Total**
Assets					
Cash and bank balances	66,664	3,301	5	64	**70,034**
Debt investment securities	219,951	194,588	-	-	**414,539**
Derivatives financial instruments	576	-	-	-	**576**
Loans	465,527	634,725	-	38,820	**1,139,072**
Deferred income	(2,400)	(4,904)	-	(322)	**(7,626)**
Impairment losses on loans	(13,184)	(16,640)	-	(307)	**(30,131)**
Equity investments	32,174	15,496	-	5,096	**52,766**
Other assets	8,836	15,186	337	1,293	**25,652**
Total	778,144	841,752	342	44,644	**1,664,882**
Liabilities					
Borrowings	73,179	622,577	93,423	73,354	**862,533**
Derivative financial instruments	35,100	-	-	-	**35,100**
Payables and accrued interest	6,624	7,808	50	1,086	**15,568**
Total	114,903	630,385	93,473	74,440	**913,201**
Net financial instruments	663,241	211,367	(93,131)	(29,796)	**751,681**
Derivative financial instruments	101,524	(212,931)	93,119	34,628	**16,340**
Currency balance at 31 December 2016	**764,765**	**(1,564)**	**(12)**	**4,832**	**768,021**

b) Interest rate risk

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

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

	Interest bearing					
Presented in EUR (000)	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Non-interest bearing	**Total**
Assets						
Cash and bank balances	81,478	-	-	-	3	**81,481**
Debt investment securities	59,297	60,000	9,169	164,058	-	**292,524**
Derivative financial instruments	-	-	-	-	1,659	**1,659**
Loans	184,975	228,824	549,697	171,585	-	**1,135,081**
Equity investments	-	-	-	-	31,361	**1,361**
Other assets	-	-	-	-	26,157	**26,157**
Total	325,750	288,824	558,866	335,643	59,180	**1,568,263**
Liabilities						
Borrowings	-	53,071	77,687	591,834	-	**722,592**
Derivative financial instruments	-	-	-	-	18,242	**18,242**
Payables and accrued interest	-	-	-	-	15,422	**15,422**
Total	-	53,071	77,687	591,834	33,664	**756,256**
Derivative financial instruments	(12,351)	(98,071)	(371,615)	482,037	-	-
Interest rate risk at 31 December 2017	**313,399**	**137,682**	**109,564**	**225,846**	**25,516**	**812,007**

	Interest bearing					
Presented in EUR (000)	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Non-interest bearing	**Total**
Assets						
Cash and bank balances	70,033	-	-	-	1	**70,034**
Debt investment securities	139,366	100,000	18,974	156,199	-	**414,539**
Derivative financial instruments	-	-	-	-	576	**576**
Loans	229,165	303,343	530,744	75,820	-	**1,139,072**
Equity investments	-	-	-	-	52,766	**52,766**
Other assets	-	-	-	-	25,652	**25,652**
Total	**438,564**	**403,343**	**549,718**	**232,019**	**78,995**	**1,702,639**
Liabilities						
Borrowings		64,346	82,873	715,314	-	**862,533**
Derivative financial instruments	-	-	-	-	35,100	**35,100**
Payables and accrued interest	-	-	-	-	15,568	**15,568**
Total	**-**	**64,346**	**82,873**	**715,314**	**50,668**	**913,201**
Derivative financial instruments	(14,168)	(106,348)	(421,390)	541,906	-	-
Interest rate risk at 31 December 2016	**424,396**	**232,649**	**45,455**	**58,611**	**28,327**	**789,438**

c) Sensitivity analysis

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

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

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Euro	588,000	329,000
United states dollar	200,000	(105,000)
Total re-pricing gap	788,000	224,000
Shift of 50 basis points in the EUR curve	**3,938**	**1,119**

Operational Risk

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

Where any such risks are identified, appropriate mitigation and control measures are put in place. The Bank's operational risk management focuses on proactive measures to mitigate the operational risk. The Bank is committed to following the best practices and market standards in the areas of accountability, transparency and business ethics. Due diligence on customers and counterparties takes into consideration the Anti-Fraud Corruption and Monetary Laundering Policy and Know-Your Customer Procedures.

Classification and Fair Value

a) Classification

All loans are classified as 'at amortized cost', except for those loans classified as 'at fair value through profit or loss (FVTPL)' that do not meet the sole payments of principal and interest (therefore have not passed the SPPI test) as determined by the Bank.

Investment securities classified as FVTOCI include government and corporate bonds and Euro Commercial Paper, and their fair value has been determined using quoted prices.

Equity investments classified as FVTPL include investments that are quoted on an exchange (i.e. private equity) or those elected having their fair value based on cash outflows and inflows. Equity investments classified as 'at fair value through other comprehensive income FVTOCI include investments that are not quoted on an exchange (i.e. private equity), the fair value of which has been estimated with techniques that use inputs not based on observable market data.

b) Financial assets and liabilities

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

	At 31 December 2017		
Presented in EUR (000)	Fair value through profit or loss (mandatory)	Amortized cost	**Carrying amount**
Assets			
Cash and bank balances	-	81,481	**81,481**
Loans	2,722	1,132,358	**1,135,080**
Deferred income	-	(6,219)	**(6,219)**
Impairment losses on loans	-	(47,996)	**(47,996)**
Other assets	-	26,157	**26,157**
Total financial assets	**2,722**	**1,185,781**	**1,188,503**
Liabilities			
Borrowings	-	722,592	**722,592**
Payables and accrued interest	-	15,422	**15,422**
Total financial liabilities	**-**	**738,014**	**738,014**

	At 31 December 2016		
Presented in EUR (000)	Loans and receivables	Amortized cost	**Carrying amount**
Assets			
Cash and bank balances	-	70,034	**70,034**
Loans	1,139,072	-	**1,139,072**
Deferred income	-	(7,626)	**(7,626)**
Impairment losses on loans	(30,131)	-	**(30,131)**
Other assets	25,652	-	**25,652**
Total financial assets	**1,134,593**	**62,408**	**1,197,001**
Liabilities			
Borrowings	-	862,533	**862,533**
Payables and accrued interest	-	15,568	**15,568**
Total financial liabilities	**-**	**878,101**	**878,101**

The following table shows the original measurement categories under IAS 39 and the new measurement categories in accordance with IFRS 9 for the Bank's financial instruments as at 1 January 2017.

Presented in EUR (000)	At 1 January 2017			
	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	**New carrying amount under IFRS 9**
Assets				
Cash and bank balances	Amortized cost	Amortized cost	70,034	**70,034**
Loans	Loans and receivables	Amortized cost	1,139,072	**1,136,350**
Deferred income	Amortized cost	Amortized cost	(7,626)	**(7,626)**
Impairment losses on loans	Loans and receivables	Amortized cost	(30,131)	**(41,480)**
Other assets	Loans and receivables	Amortized cost	25,652	**25,652**
Total financial assets			**1,197,001**	**1,182,930**
Liabilities				
Borrowings	Amortized cost	Amortized cost	862,533	**862,533**
Payables and accrued interest	Amortized cost	Amortized cost	15,568	**15,568**
Total financial liabilities			**878,101**	**878,101**

c) Fair value hierarchy

For those above financial instruments measured at fair value, the Bank uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

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

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

Presented in EUR (000)	Level 1	Level 2	Level 3	**Carrying Amount**
Derivative financial instruments – assets	-	1,659	-	**1,659**
Fair value through profit or loss:				
Loans	-	2,722	-	**2,722**
Equity investments	-	-	1,600	**1,600**
Fair value through other comprehensive income:				
Debt investment securities	292,524			**292,524**
Equity investments	-		29,761	**29,761**
Derivative financial instruments – liabilities	-	(18,242)	-	**(18,242)**
At 31 December 2017	**292,524**	**(13,861)**	**31,361**	**310,024**

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

Presented in EUR (000)	Level 1	Level 2	Level 3	Carrying Amount
Derivative financial instruments – assets	-	576	-	**576**
Available-for-sale:				
Debt investment securities	414,539	-	-	**414,539**
Equity investments	-	-	52,766	**52,766**
Derivative financial instruments – liabilities	-	(35,100)	-	**(35,100)**
At 31 December 2016	**414,539**	**(34,524)**	**52,766**	**432,781**

The following table shows the original measurement categories under IAS 39 and the new measurement categories in accordance with IFRS 9 for the Bank's financial instruments as at 1 January 2017.

				At 1 January 2017
Presented in EUR (000)	Original classification under IAS 39	New classification under IFRS 9	Original carrying amount under IAS 39	**New carrying amount under IFRS 9**
Derivative financial instruments – assets	FVTPL	FVTPL (mandatory)	576	576
Fair value through profit or loss:				
Loans	Amortized cost	FVTPL (mandatory)	4,939	4,939
Equity investments	Available- for-sale	FVTPL (elected)	5,162	5,162
Fair value through other comprehensive income:				
Debt investment securities	Available-for-sale	FVTOCI (elected)	414,539	414,539
Equity investments	Available-for-sale	FVTOCI (elected)	47,604	47,604
Derivative financial instruments – liabilities	FVTPL	FVTPL (mandatory)	(35,100)	(35,100)
At 31 December 2016			437,720	437,720

d) Fair value measurement in level 3

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

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
At 1 January	52,766	63,800
Total gains or (losses) recognized in the income statement	1,600	(4,404)
Total gains or (losses) recognized in other comprehensive income	(21,641)	(4,097)
Purchases, sales, issues and settlements	(1,364)	(2,533)
At end of year	**31,361**	**52,766**

e) Sensitivity analysis for level 3

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

Presented in EUR (000)	Carrying amount	Favorable change	Unfavorable change
Equity investments	31,361	1,568	(1,568)

Capital Management

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

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

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

The capital usage of the Bank is guided by statutory and financial policy parameters. Article 15 of the Establishing Agreement limits the total amount of outstanding loans, equity investments and guarantees made for ordinary operations to 150% of the Bank's unimpaired subscribed capital, reserves and surpluses, establishing a 1.5:1 institutional gearing ratio. Additionally, disbursed equity investments shall not at any time exceed an amount corresponding to the Bank's total unimpaired paid-in capital, surpluses and general reserve.

At the 36th meeting of the Board of Directors in 2008, the operational gearing ratio was set at 100% of the Bank's unimpaired paid-up capital, reserves and surpluses, and the usable portion of the callable capital. This limit on the total amount of operations, which includes all callable capital, is approximately EUR 2.2 billion.

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

6. OPERATING SEGMENTS

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

	2017			2016		
Presented in EUR (000)	Lending	Treasury	Total	Lending	Treasury	Total
Income statement						
Interest income	61,512	8,293	69,805	61,806	6,170	67,976
Net fees and commissions	2,087	-	2,087	1,746	2	1,748
Other income (expense)	5,975	482	6,457	747	4	751
Total segment revenues	69,574	8,775	78,349	64,299	6,176	70,475
Less: interest expense	(36,726)	(5,311)	(42,037)	(32,744)	(5,427)	(38,171)
Net fair value and foreign exchange	-	2,110	2,110	-	(1,488)	(1,488)
Less: personnel and other admin. expenses	(18,195)	(1,085)	(19,280)	(17,624)	(875)	(18,499)
Less: depreciation and amortization	(451)	(10)	(461)	(579)	(11)	(590)
Segment income before impairment	14,202	4,479	18,681	13,352	(1,625)	11,727
Less: impairment / fair value (losses)	(9,750)	(276)	(10,026)	(9,976)	-	(9,976)
Net income for the year	**4,452**	**4,203**	**8,655**	**3,376**	**(1,625)**	**1,751**

	31 December 2017			31 December 2016		
Presented in EUR (000)	Lending	Treasury	Total	Lending	Treasury	Total
Financial position						
Segment assets	1,139,538	375,388	1,514,926	1,180,722	485,149	1,665,871
At end of year			**1,514,926**			**1,665,871**
Segment liabilities	738,014	18,242	756,256	878,101	35,100	913,201
Members' equity	-	-	758,670	-	-	752,670
At end of year			**1,514,926**			**1,665,871**

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

7. INTEREST INCOME

Interest and similar income is analyzed as follows:

Presented in EUR (000)	Year to 31 December 2017	Year to 31 December 2016
From loans and advances	61,512	61,806
From placements with financial institutions	7	5
From investment securities at fair value through OCI (2016: AFS)	6,627	5,044
From derivative financial assets at fair value through profit or loss	1,659	1,121
Interest income	**69,805**	**67,976**

8. INTEREST EXPENSE

Interest and similar expense is analyzed as follows:

Presented in EUR (000)	Year to 31 December 2017	Year to 31 December 2016
From borrowed funds	8,045	8,422
From issued debt	27,132	23,149
From derivative financial liabilities at fair value profit or loss	4,812	5,037
From amortized issuance and arrangement costs	1,549	1,173
From other charges	499	390
Interest expense	**42,037**	**38,171**

9. NET FEES AND COMMISSIONS

Net fees and commissions is analyzed as follows:

Presented in EUR (000)	Year to 31 December 2017	Year to 31 December 2016
Guarantee fees	235	180
Management fees	461	490
Appraisal fees	259	116
Administration fees	57	81
Surveillance fees	71	69
Prepayment / cancellation fees	884	675
Other fees	120	137
Net Fees and commissions	**2,087**	**1,748**

10. PERSONNEL AND OTHER ADMINISTRATIVE EXPENSES

Administrative expenses are analyzed as follows:

Presented in EUR (000)	Year to 31 December 2017	Year to 31 December 2016
Salaries and benefits	11,505	11,490
Staff retirement plans	3,270	2,827
Personnel expenses	**14,775**	**14,317**
Professional fees and related expenses	1,003	860
Utilities and maintenance	1,454	1,395
Other administrative	2,048	1,927
Other administrative expenses	**4,505**	**4,182**

The average number of staff employed during the year 112 (2016: 109). The number of staff at 31 December 2017 was 112 (2016: 110). Further analysis of the staff retirement plan is presented in note 'Employee benefits'.

11. IMPAIRMENT LOSSES ON LOANS

Loans that are measured at amortized cost are stated net of provisions for impairment, which includes also their related provisions for impairment on undrawn commitments. A summary of the movements in provisions for impairment were as follows:

	Under IFRS 9			Under IAS 39		Total
Presented in EUR (000)	Stage 1	Stage 2	Stage 3	Collective	Specific	Total
At 31 December 2015	-	-	-	8,498	18,058	26,556
Charge	-	-	-	6,359	7,241	13,600
Release	-	-	-	(6,659)	(1,079)	(7,738)
Against write-offs	-	-	-	-	(2,812)	(2,812)
Foreign exchange adjustments	-	-	-	247	278	525
At 31 December 2016	-	-	-	8,445	21,686	30,131
IFRS 9 transition	(3,711)	2,289	12,771	-	-	11,349
At 1 January 2017	2,234	4,515	34,731	-	-	41,480
Charge	401	-	19,238	-	-	19,639
Release	(3,388)	(6,918)	(208)	-	-	(10,514)
Transfer	2,578	3,794	(6,372)	-	-	-
Against write-offs	-	-	(485)	-	-	(485)
Foreign exchange adjustments	(372)	(303)	(1,449)	-	-	(2,124)
At 31 December 2017	**1,453**	**1,088**	**45,455**	**-**	**-**	**47,996**

At each reporting date, the Bank recognizes loss allowances based on either 12-month ECL or lifetime ECL, depending on whether there has been a significant movement in credit risk on the financial instrument since its initial recognition. The IFRS 9 transition is the amount arising by the reclassification of these financial assets from IAS 39, which reduced such amount in retained earnings.

Staging Criteria 12-month ECL (Stage 1)

As IFRS 9 does not distinguish between individually significant or not individually significant financial instruments, the Bank measures potential credit losses for all non-impaired operations (Stage 1 and Stage 2) on an individual operation basis based on the asset class. Their PD and LGD are multiplied by general market scenarios assigned within the Moody's Analytics IFRS ImpairmentCalc tool. Provisions for impairment in Stage 1 are therefore not directly related to the specifics of any particular operation. They are meant to protect against potential risks that are considered present, or within a 12-month horizon, and derived from potentially adverse developments in operating conditions beyond the control of individual borrowers.

Staging Criteria lifetime ECL (Stages 2 and 3)

When an operation deteriorates substantially in credit quality, it enters Stage 2 and an expected credit loss calculation is performed on a Lifetime Expected Credit Loss (LECL) basis. Stage 2 operations are those that have experienced an overall credit quality downgrade but are still performing. They are not considered credit impaired.

Stage 3 operations have objective evidence of impairment that immediately impacts the ECL.

Revolving facilities and undrawn commitments

Revolving credit facilities have no fixed term and they can be cancelled at the Bank's discretion at any point in time. These facilities are subject to, at a minimum, an annual credit review. In this regard, the date of the latest credit review provides the relevant date to assess if there is any increase in credit risk, as at that point in time. The Bank may amend the terms and conditions of the exposure.

The estimate of the expected credit losses on irrevocable loan commitments is consistent with its expectations of drawdowns on that loan commitment. Therefore, the Bank considered (i) the expected portion of the loan commitment that will be drawn down within 12 months of the reporting date when estimating 12-month expected credit losses and (ii) the expected portion of the loan commitment that will be drawn down over the expected life of the reporting date when estimating lifetime expected credit losses. At 31 December 2017 the amount of expected credit losses was EUR 112 thousand.

12. DEBT INVESTMENT SECURITIES

Debt investment securities are analyzed as follows:

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Government bonds	53,105	39,439
Corporate bonds	129,419	128,153
Commercial papers	110,000	246,947
Debt investment securities fair value through OCI (2016: AFS)	292,524	414,539
Less: impairment losses	(276)	-
Debt investment securities net of impairment	**292,248**	**414,539**

13. DERIVATIVE FINANCIAL INSTRUMENTS

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

Presented in EUR (000)	At 31 December 2017			At 31 December 2016		
	Notional amount	Fair value		Notional amount	Fair value	
		Assets	Liabilities		Assets	Liabilities
Currency swap purchases	52,174	52,174	-	40,000	40,000	-
Currency swap sales	(51,543)	(50,968)	-	(40,149)	(39,691)	-
Designated fair value hedges	-	453	(18,242)	-	267	(35,100)
Derivative financial instruments	**631**	**1,659**	**(18,242)**	**(149)**	**576**	**(35,100)**

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

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

14. LOANS

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

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Loans at amortized cost:		
At 1 January	1,139,072	1,049,732
Disbursements	386,211	443,738
Less: repayments	(318,214)	(366,957)
Disposal	-	-
Write-offs	(485)	(2,812)
Foreign exchange movements	(74,225)	15,371
Outstanding disbursements	1,132,359	1,139,072
Less: deferred income	(6,219)	(7,626)
Less: impairment losses	(47,996)	(30,131)
Loans at fair value:		
Outstanding disbursements	4,939	-
Fair value adjustment	(2,217)	-
Loans net of impairment	**1,080,866**	**1,101,315**

At 31 December 2017 the principal amount of outstanding disbursements was EUR 1,137,298 thousand. As of this date the amount of interest and similar income that has not been accrued related to impaired loans was EUR 13,832 thousand, out of which an amount of EUR 808 thousand refers to the current year.

In 2017 the Bank had one restructured loan operation for the reporting year.

The carrying amount of loans under IFRS 9 with respect to their related stages and allowance for impairment is analyzed as follows:

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Stage 1	995,590	-
Less: deferred income	(6,219)	-
Less: allowance for impairment	(1,453)	-
Carrying amount	987,918	-
Stage 2	75,623	-
Less: allowance for impairment	(1,088)	-
Carrying amount	74,535	-
Stage 3	61,146	-
Less: allowance for impairment	(45,455)	-
Carrying amount	15,691	-
Fair value through profit or loss	2,722	-
Carrying amount	**1,080,866**	**-**

The carrying amount of loans under IAS 39 is analyzed as follows:

Presented in EUR (000)	At 31 December 2016
Collectively impaired	1,062,848
Less: deferred income	(7,626)
Less: allowance for impairment	(8,416)
Carrying amount	1,046,806
Past due but not impaired	3,558
Less: allowance for impairment	(29)
Carrying amount	3,529
Individually impaired	72,666
Less: allowance for impairment	(21,686)
Carrying amount	50,980
Carrying amount at amortized cost	**1,101,315**

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

15. EQUITY INVESTMENTS

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

		At 31 December 2017		At 31 December 2016	
Presented in EUR (000)	% of Investment	Cost	Fair value	Cost	Fair value
Balkan Accession Fund	9.09	-	1,600	3,032	5,162
At fair value through profit or loss		-	1,600	3,032	5,162
SEAF Caucasus Growth Fund	21.39	7,040	5,499	7,812	6,024
Access Bank, Azerbaijan	20.00	14,148	-	9,118	5,095
A-Park Kaluga, Russia	19.99	1,714	340	1,714	1,979
Emerging Europe Accession Fund	10.15	1,840	6,921	4,897	10,218
Rusal	0.01	4	248	4	170
ADM Ceecat Recovery Fund	5.65	6,636	7,422	8,687	10,155
European Virgin Fund	21.05	8,724	8,933	9,925	9,303
Teamnet International	8.33	5,599	398	5,599	4,660
Natfood	0.01	-	-	-	-
At fair value through other comprehensive income		45,705	29,761	47,756	47,604
Equity investments at fair value		**45,705**	**31,361**	**50,788**	**52,766**

The valuation of such investments, which are unlisted, has been estimated using the most recent management accounts or the latest audited accounts as of 31 December 2017, as Management considers that is the best available estimate of the investments fair value. The techniques applied to perform these valuations include equity calculations based on EBITDA and market data.

The decrease of EUR 14,344 thousand corresponds to the difference between acquisition cost and fair value as of 31 December 2017.

During the year the Bank had realized a dividend income of EUR 1,715 thousand from its investment in the A-Park Kaluga. In addition, the Bank had realized a net income of EUR 4,263 thousand from its investment in the Balkan Accession Fund.

On disposal or exit of an equity investment for those at fair value through other comprehensive income, the cumulative gain or loss is realized with a corresponding reversal of the unrealized gain or loss that was recorded prior to the exit from that investment, is not recycled to the income statement.

As of 31 December 2017 the Bank has a committed amount of EUR 6,417 thousand towards the above entities participation. Further analysis of the equity investment portfolio is presented in note 'Operational analysis'.

As at 31 December 2017 the Bank has three equity investments where it holds slightly more than 20% of the investee share capital, but does not exert significant influence, hence the investment is not accounted for as an investment in an associate under IAS 28.

16. OPERATIONAL ANALYSIS

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

	At 31 December 2017		At 31 December 2016	
Presented in EUR (000)	Outstanding balance	Undrawn commitments	Outstanding balance	Undrawn commitments
Analysis by instrument				
Loans	1,135,081	166,733	1,139,072	138,150
Equity investments	31,361	6,417	52,766	8,238
Guarantees	-	12,413	-	13,803
At end of year	**1,166,442**	**185,563**	**1,191,838**	**160,191**
Analysis by country				
Albania	42,468	175	43,481	11,664
Armenia	84,051	447	97,341	5,317
Azerbaijan	60,710	18,791	91,296	27,160
Bulgaria	100,252	526	85,645	731
Georgia	67,025	21,552	78,270	28,607
Greece	173,203	7,500	95,314	-
Moldova	36,060	8,100	10,914	4,593
Romania	116,332	15,734	145,728	1,014
Russia	180,383	505	220,862	529
Turkey	273,993	110,707	263,790	79,174
Ukraine	31,965	1,526	59,197	1,402
At end of year	**1,166,442**	**185,563**	**1,191,838**	**160,191**
Loans analysis by sector				
Consumer discretionary	26,129	-	46,519	-
Consumer staples	108,635	7,284	120,509	-
Energy	106,176	-	78,949	6,432
Financial institutions	386,337	49,040	367,265	47,547
Health care	61,177	107,492	43,251	75,371
Industrials	158,241	2,917	92,178	-
Information technology	9,000	-	9,875	-
Materials	129,065	-	195,611	-
Real estate	2,723	-	5,878	-
Telecom services	33,330	-	50,000	8,800
Utilities	114,268	-	129,037	-
At end of year	**1,135,081**	**166,733**	**1,139,072**	**138,150**

The Bank is restricted to operating in its 11 Member States and individual country limits are set as a maximum at 30% of planned 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 coordinated by the Department of Project Implementation and Monitoring, with inputs from the originated Banking Teams regarding the availability of financial data. Monitoring reports are completed by the Bank's Department of Project Implementation and Monitoring based on financial analysis prepared by the Department of Financial Analysis. Risk asset reviews, based on the mentioned monitoring reports, are performed by the Department of Risk Management, and may result in a downgrade or upgrade of an operation's status and, if a significant deterioration is noted, trigger an impairment test.

17. PROPERTY AND EQUIPMENT

Property and equipment is analyzed as follows:

Presented in EUR (000)	Buildings (leasehold)	Vehicle	Furniture and office accessories	Computers and office equipment	Total
Cost					
At 31 December 2015	790	95	594	1,585	3,064
Additions	37	105	21	89	252
Disposals	-	(95)	(38)	(154)	(287)
At 31 December 2016	827	105	577	1,520	3,029
Additions	23	1	20	219	263
Disposals	-	-	(47)	(17)	(64)
At 31 December 2017	**850**	**106**	**550**	**1,722**	**3,228**
Accumulated depreciation					
At 31 December 2015	619	90	502	1,232	2,443
Charges	126	17	40	180	363
Disposals	-	(95)	(38)	(154)	(287)
At 31 December 2016	745	12	504	1,258	2,519
Charges	52	22	34	164	272
Disposals	-	-	(47)	(17)	(64)
At 31 December 2017	**797**	**34**	**491**	**1,405**	**2,727**
Net book value					
At 31 December 2017	**53**	**72**	**59**	**317**	**501**
At 31 December 2016	82	93	73	262	510
At 31 December 2015	171	5	92	353	621

18. INTANGIBLE ASSETS

Intangible assets comprising computer software are analyzed as follows:

Presented in EUR (000)	Total
Cost	
At 31 December 2015	3,753
Additions	222
At 31 December 2016	3,975
Additions	367
At 31 December 2017	**4,342**
Accumulated amortization	
At 31 December 2015	3,270
Charges	226
At 31 December 2016	3,496
Additions	193
At 31 December 2017	**3,689**
Net book value	
At 31 December 2017	**653**
At 31 December 2016	479
At 31 December 2015	483

19. OTHER ASSETS

Other assets are analyzed as follows:

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Accrued interest	16,974	17,612
Advances and prepaid expenses	5,850	5,545
Other prepayments	184	184
Guarantee deposits	3,149	2,311
Other assets	**26,157**	**25,652**

20. BORROWINGS

Borrowing facilities and bond issuance, arranged as at the financial position date, are analyzed below. In addition to medium- or long-term borrowings and bond issuance, the Bank utilizes short-term financing in the form of ECP issuance or borrowings from commercial banks for cash management purposes. At 31 December 2017, the Bank had issued debt securities in the amount of EUR 555,404 thousand.

	At 31 December 2017		At 31 December 2016	
Presented in EUR (000)	Amount used	Amount arranged	Amount used	Amount arranged
Euro	76,756	96,756	73,179	113,179
United States dollar	500,214	583,596	622,577	622,577
Japanese yen	-	-	12,155	12,155
Swiss franc	85,667	85,667	93,423	93,423
Romanian lei	21,850	21,850	22,380	22,380
Georgian lari	34,650	34,650	38,819	38,819
Armenian dram	3,455	3,455	-	-
Total	**722,592**	**825,974**	**862,533**	**902,533**

The Interest rate on borrowings falls within an approximate range of Euribor or USD Libor of +0 to +375 basis points. There is no collateral against the above borrowed funds. The fair value of the borrowings is approximately equal to their carrying value.

21. PAYABLES AND ACCRUED INTEREST

Payables and accrued interest is analyzed as follows:

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Accrued interest	9,136	9,913
Social insurance fund (IKA) contributions	5	4
Pension plan obligation	5,232	4,648
Suppliers and other accrued expenses	990	953
Other	59	50
Payables and accrued interest	**15,422**	**15,568**

22. SHARE CAPITAL

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

thousand and one hundred and fifty EUR (1,150) each, inclusive of all subscribed and unallocated shares. Accordingly, as of the Effective Date, all outstanding share capital commitments of participating members in respect of their subscribed shares were converted into EUR.

The Bank's authorized capital stock may be increased at such time and under such terms as may seem advisable.

The Bank's capital stock is divided into paid-in shares (fully paid and payable in installments) and callable shares. Payment for the paid-in shares subscribed to by members was made over a period of years in accordance with Article 6 of the Establishing Agreement for the initial capital raising purpose of the Bank, and as determined in advance by the Bank for capital increases (in the only capital increase of the Bank so far, the structure of payments specified was similar to the one in Article 6). The same Article states that payment of the amount subscribed to in respect of the callable shares is subject to call only as and when required by the Bank to meet its obligations.

Under Article 37 of the Establishing Agreement any member may withdraw from the Bank by transmitting a notice in writing to the Bank at its headquarters. Withdrawal by a member shall become effective and its membership shall cease on the date specified in its notice, but in no event less than six months after such notice is received by the Bank. However, at any time before the withdrawal becomes finally effective, the member may notify the Bank in writing of the cancellation of its notice of intention to withdraw. Under Article 39 of the Establishing Agreement after the date on which a member ceases membership, it shall remain liable for its direct obligations to the Bank, and also remain responsible for its contingent liabilities to the Bank, incurred as of that date. No member has ever withdrawn its membership, nor has any ever indicated to the Bank it might do so. Were a member to withdraw from the Bank, at the time a member ceases membership, the Bank shall arrange for the repurchase of such a member's shares by the Bank as part of the settlement of accounts with such a member, and be able to impose conditions and set dates pursuant to the same Article 39 of the Establishing Agreement. Any amount due to the member for its shares shall be withheld so long as the member, including its central bank or any of its agencies, has outstanding obligations to the Bank, which may, at the option of the Bank, be applied to any such liability as it matures.

If losses are sustained by the Bank on any guarantees or loans which were outstanding on the date when a member ceased membership and the amount of such losses exceeds the amount of the reserves provided against losses on the date, the member concerned shall repay, upon demand, the amount by which the repurchase price of its shares would have been reduced if the losses had been taken into account when the repurchase price was determined.

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

All participating members had fully subscribed to the initial authorized share capital in accordance with Article 5 of the Establishing Agreement. Subsequently, at the Sixth Annual Meeting of the Board of Governors held on 6 June 2004, three Member States, Armenia, Georgia and Moldova, requested a 50% reduction of their portion of subscribed capital, from 2% to 1% of the initial authorized capital the Board of Governors approved their request. On 5 October 2008 the new shares pursuant to the capital increase of the Bank were offered in the same structure as the initial authorized share capital, in the amount of EUR 1.15 billion, and were fully subscribed by the Member States. Furthermore, Azerbaijan also subscribed to the 3% of the initial authorized share capital that remained unallocated, after the above-mentioned participation reduction, while Romania subscribed both to their allocation of new shares and to those that would have been allocated to Georgia had it chosen to participate in the capital increase. This subscription process followed a decision taken by the Board of Governors in December 2007 to triple the Bank's authorized capital to EUR 3.45 billion and to double the subscribed capital to EUR 2.3 billion, while leaving authorized capital of EUR 1.15 billion unallocated. On October 2011 the Board of Governors approved the request from Moldova for a 50% reduction of its portion of subscribed capital, from 1% to 0.5%, and those shares were released to unallocated share capital.

The above share capital is analyzed as follows:

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Authorized share capital	3,450,000	3,450,000
Less: unallocated share capital*	(1,161,500)	(1,161,500)
Subscribed share capital	2,288,500	2,288,500
Less: shares not yet called	(1,601,950)	(1,601,950)
Less: shares payable but not yet due	(44,984)	(72,741)
Less: shares payments past due	-	-
Paid-up share capital	641,566	613,809
Advance against future call	-	-
Paid-in share capital	**641,566**	**613,809**

* Shares available to new or existing Member States.

Initial Capital

In accordance with paragraph 2 under Article 5 of the Establishing Agreement, the initially authorized capital stock was subscribed by and issued to each Member as follows: 10% (EUR 115 million) fully paid and 20% (EUR 230 million) payable by promissory notes or other obligations which were not negotiable and non-interest bearing in eight equal successive annual installments in the years 1998 to 2005.

Capital Increase

The capital increase of EUR 1.15 billion is divided into EUR 345 million paid in capital and EUR 805 million callable capital. Pursuant to the Board of Governors decision in October 2008, the EUR 345 million paid in portion is divided into 10% (EUR 115 million) fully paid shares in 2010 and 20% (EUR 230 million) payable shares by promissory notes or other obligation issued by members in eight equal successive annual installments in the years 2011 to 2018. As of October 2011, the capital increase was reduced by EUR 11.5 million of the subscribed share capital, due to an approved reduction by the Board of Governors in participation by Moldova.

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

	At 31 December 2017		
Presented in EUR (000)	Initial capital	Capital increase	**Total**
Authorized share capital	1,150,000	2,300,000	**3,450,000**
Less: unallocated share capital	(34,500)	(1,127,000)	**(1,161,500)**
Subscribed share capital	1,115,500	1,173,000	**2,288,500**
Less: shares not yet called	(780,850)	(821,100)	**(1,601,950)**
Less: shares payable but not yet due	-	(44,984)	**(44,984)**
Less: shares payments past due	-	-	**-**
Paid-up share capital	334,650	306,916	**641,566**
Advance against future call	40	(40)	**-**
Paid-in share capital	**334,690**	**306,876**	**641,566**

Statement of Subscriptions

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

Member	Shares	Subscribed	Callable	Payable	Paid
		Presented in EUR (000)			
Albania	40,000	46,000	32,200	1,725	12,075
Armenia	20,000	23,000	16,100	288	6,612
Azerbaijan	100,000	115,000	80,500	1,438	33,062
Bulgaria	270,000	310,500	217,350	3,881	89,269
Georgia	10,000	11,500	8,050	-	3,450
Greece	330,000	379,500	265,650	4,744	109,106
Moldova	10,000	11,500	8,050	-	3,450
Romania	280,000	322,000	225,400	4,168	92,432
Russian Fed.	330,000	379,500	265,650	4,744	109,106
Turkey	330,000	379,500	265,650	4,744	109,106
Ukraine	270,000	310,500	217,350	19,252	73,898
Total	**1,990,000**	**2,288,500**	**1,601,950**	**44,984**	**641,566**

23. RESERVES

Reserves are analyzed as follows:

Presented in EUR (000)	General	Other comprehensive income	Other	Total
At 31 December 2015	53,655	139	(344)	53,450
Gains (losses) on revaluation of investments	-	(5,003)	-	(5,003)
Remeasurements of defined benefit scheme	-	-	(3,021)	(3,021)
Transferred from retained earnings	1,751	-	-	1,751
At 31 December 2016	55,406	(4,864)	(3,365)	47,177
Gains (losses) on revaluation of investments	-	(19,294)	-	(19,294)
Remeasurements of defined benefit scheme	-	-	231	231
Transferred from retained earnings	5,469	-	-	5,469
At 31 December 2017	**60,875**	**(24,158)**	**(3,134)**	**33,583**

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

24. CLASSIFICATION OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES ON THE DATE OF INITIAL APPLICATION OF IFRS 9

The following table analyses the impact of transition to IFRS 9 on retained earnings. The impact relates to the retained earnings. There is no impact on other components of members' equity.

Presented in EUR (000)	Impact of adopting IFRS 9 at 1 January 2017
Retained earnings	
Closing balance under IAS 39 (31 December 2016)	91,684
Recognition of expected credit losses under IFRS 9 (including lease receivables, loan commitments and financial guarantee contracts)	(11,349)
Opening balance under IFRS 9 (1 January 2017)	**80,335**

The recognition of expected credit losses is due to the adoption of IFRS 9 as the Bank recorded a one-time transition effect on retained earnings of negative EUR 11,349 thousand. This transition impact represents as if the new classification, in accordance with IFRS 9, had been applied retrospectively.

Under IFRS 9, expected credit losses are based on reasonable and supportable forward-looking information obtainable without undue cost or effort, which takes into consideration past events, current conditions and forecasts of future economic conditions.

The following table reconciles:

- The closing impairment allowance for financial assets in accordance with IAS 39 and provisions for loan commitments and financial guarantee contracts in accordance with IAS 37: Provisions, Contingent Liabilities and Contingent Assets as at 31 December 2016.
- The opening ECL allowance determined in accordance with IFRS 9 as at 1 January 2017.

Presented in EUR (000)	At 31 December 2016 IAS 39/IAS 37	Reclassification	Remeasurement	At 1 January 2017 IFRS 9
Loans and receivables and held to maturity securities under IAS 39/ financial assets at amortized cost under IFRS 9 (includes cash and cash equivalents, loans and advances to banks and advances to customers)	1,209,106	(4,939)	(11,349)	1,192,818
Available-for-sale debt investment securities under IAS 39/ debt financial assets at FVTOCI under IFRS 9	414,539	-	-	414,539
Loan commitments and financial guarantee contracts	151,953	-	-	151,953
Total	**1,775,598**	**(4,939)**	**(11,349)**	**1,759,310**

25. CASH AND CASH EQUIVALENTS

Cash and cash equivalents are analyzed as follows:

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Cash on hand	3	1
Investments maturing up to 1 month:		
Cash deposits at banks	81,478	70,033
At fair value through other comprehensive income portfolio	55,000	137,973
Investment maturing from 1 month to 3 months:		
At fair value through other comprehensive income portfolio	60,000	100,070
Cash and cash equivalents	**196,481**	**308,077**

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

26. EMPLOYEE BENEFITS

Under the Defined Benefit Scheme

If separated at or after the normal retirement age (60 years old), a staff member will be entitled to a full immediate pension equal to 1% of his annual pensionable salary (i.e. average of the two best out of the last five years) multiplied by his/her years of service at the Bank. If separated at or after the early retirement age (55 years old), as staff member will be entitled to a reduced immediate pension, or deferred pension payable from any month until the staff member's normal retirement age. If separated before the early retirement age, a staff member will be entitled to a deferred pension payable from any month between the staff member's early and normal retirement age. Upon separation at any age, a staff member will have a choice between the appropriate type of pension and a lump-sum termination benefit.

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's accounts. The most recent valuation date was 31 December 2017. The present value of the defined benefit obligation and current service cost was calculated using the projected unit credit method.

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Amounts recognized in the statement of financial position		
Present value of the defined benefit obligations	27,111	25,021
Fair value of plan assets	(21,879)	(20,373)
Net liability at end of the year	**5,232**	**4,648**
Amounts recognized in the income statement		
Service cost	2,124	1,748
Net interest on the net defined benefit liability/(asset)	75	19
Administration expense	47	64
Total included in personnel expenses	**2,246**	**1,831**
Remeasurements recognized in other comprehensive income		
At 31 December	(6,952)	(3,931)
Liability gain (loss) due to changes in assumptions	(505)	(4,032)
Liability experiences gain (loss) arising during the year	419	601
Return on plan assets excluding income statement amounts	317	410
Total amount recognized in OCI during the year	231	(3,021)
Cumulative in other comprehensive income (expense)	**(6,721)**	**(6,952)**
Principal actuarial assumptions used		
Discount rate	1.78%	1.88%
Expected return on plan assets	1.78%	1.88%
Future salary increase	2.00%	2.00%
Future pension increase	2.00%	2.00%
Average remaining working life of employees	12 years	12 years

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

The expected return on assets as per provision of the revised IAS 19, has been set equal to the discount rate assumption, i.e. at 1.78% pa.

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

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Major categories of plan assets		
Cash instruments	14%	16%
Fixed interest	45%	40%
Equities	38%	39%
Other	3%	5%
Reconciliation of plan assets		
Market value at 1 January	20,373	18,696
Expected return	395	519
Contributions paid	1,431	1,387
Benefit pensions and lump sum paid to pensioners	(590)	(575)
Expenses	(47)	(64)
Asset gain (loss)	317	410
Fair value of plan assets	**21,879**	**20,373**

The actual investment return on assets of the Fund for the year was 4.2%. The expected return on plan assets has been based on asset structure allowed by the Fund as well as the yield of high-quality corporate bonds. The Bank estimate of contributions to be paid in 2018 will not materially differ from those paid in the current year.

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

Presented in EUR (000)	2017	2016	2015	2014	2013
Defined benefit obligations	27,111	25,021	19,879	20,321	13,879
Plan assets	(21,879)	(20,373	(18,696)	(15,657)	(13,758)
Plan deficit (surplus)	5,232	4,648	1,183	4,664	121
Net experience adjustments on plan liabilities (assets)	**(419)**	**4,032**	**(1,822)**	**5,624**	**(443)**

Sensitivity analysis

Reasonable possible changes at the financial position date to one of the relevant actuarial assumptions, holding other assumptions constant, would have affected the defined benefit obligation by the amounts shown below.

	At 31 December 2017		At 31 December 2016	
Presented in EUR (000)	Increase	Decrease	Increase	Decrease
Discount rate (1% movement)	(3,926)	3,926	(3,434)	3,434
Future salary growth (1% movement)	1,438	(1,438)	1,902	(1,902)

Although the analysis does not take into account the full distribution of cash flows expected under the plan, it does provide an approximation of the sensitivity of the assumptions shown.

Under the Defined Contribution Scheme

Upon separation, 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. The pension expense under this scheme was EUR 997 thousand (2016: EUR 962 thousand) and is included in 'Personnel expenses'.

Under the Greek State Social Insurance Fund

The pension expense of staff that is alternatively entitled to retirement benefits from this fund was EUR 27 thousand (2016: EUR 34 thousand) and is included in 'Personnel expense'.

27. OPERATING LEASES

The Bank has entered into lease contracts for its headquarters and other premises. These are operating leases and include renewal options and periodic escalation clauses. There is no commitment at end of year for non-cancellable lease contracts. Rental expenses for the year included in 'Other administrative expenses' totaled EUR 691 thousand (2016: EUR 696 thousand).

28. RELATED PARTIES

The Bank has the following related parties:

Key Management Personnel

Key management personnel comprise: the President, Vice Presidents and Secretary General. They are entitled to a staff compensation package that includes a salary (covered by medical insurance), participation in the Bank's retirement schemes, and are eligible to receive other short-term benefits. The amounts paid to key management personnel during the year were EUR 1,217 thousand (2016: EUR 1,256 thousand). Key management personnel may receive post-employment benefits, other long-term benefits and termination benefits, but do not receive any share-based payments.

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

Special funds

Special funds are established in accordance with Article 16 of the Establishing Agreement and are administered under the terms of rules and regulations adopted by the Bank. Special Funds are audited on an annual basis and their assets and fund balances are not included in the Bank's statement of financial position. During 2017 the Bank administered two special funds. Extracts from the audited financial statements are included under the 'Summary of special funds'.

29. CHANGE IN ACCOUNTING POLICIES

Except for the change below, the Bank has consistently applied the accounting policies as the previous years.

Financial Instruments

The Bank has early adopted IFRS 9: Financial Instruments, with the date of initial application of 1 January 2017. The requirements of IFRS 9 represent a significant change from IAS 39 Financial Instruments: Recognition and Measurement. The new standard brings fundamental changes to the accounting for financial assets and certain aspects of the accounting for financial liabilities.

As permitted by IFRS 9 the Bank has elected to continue to apply the hedge accounting requirements of IAS 39.

The key changes to the Bank's accounting policies resulting from the adoption of IFRS 9 are summarized below.

Classification of Financial Assets and Financial Liabilities

IFRS 9 contains three principal classification categories for financial assets: (a) measured at amortized cost (b) fair value through profit or loss ('FVTPL') and (c) fair value through other comprehensive income ('FVTOCI'). IFRS 9 classification is generally based on the business model in which a financial asset is managed and is contractual cash flows. The standard eliminates the existing IAS 39 categories of held-to-maturity, loans and receivables and available-for-sale. Under IFRS 9, derivatives embedded in contracts where the host is a financial asset in the scope of the standard are never bifurcated. Instead, the whole hybrid instrument is assessed for classification.

IFRS 9 largely retains the existing requirements in IAS 39 for the classification of financial liabilities. However, although under IAS 39 all fair value changes of liabilities designated under the fair value option were recognized in profit or loss. Under IFRS 9 fair value changes are generally presented as follows:

- The amount of change in the fair value that is attributable to changes in the credit risk of the liability is presented in other comprehensive income; and
- The remaining amount of change in the fair value is presented in income statement.

Impairment of Financial Assets

IFRS 9 replaces the previous 'incurred loss' model under IAS 39 with a new 'expected credit loss' model. The new impairment model also applies to certain loan commitments and financial guarantee contracts but not to equity investments.

Under IFRS 9, credit losses are recognized earlier than under IAS 39.

Transition

Changes in accounting policies resulting from the adoption of IFRS 9 have been applied retrospectively, except as described below:

- Comparative years have not been restated. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 are recognized in retained earnings at 1 January 2017. Accordingly, the information presented for 2016 does not reflect the requirements of IFRS 9 and therefore is not comparable to the information presented in 2017 under IFRS 9.
- The following assessments have been made on the basis of the facts and circumstances that existed at the date of initial application.
    - The determination of the business model within which a financial asset is held.
    - The designation and revocation of previous designations of certain financial assets and financial liabilities as measured at FVTPL.
    - The designation of certain investments in equity instruments not held for trading as at FVTOCI.
    - For financial liabilities designated as FVTPL, the determination of whether presenting the effects of changes in the financial liability's credit risk in other comprehensive income (OCI) would create or enlarge an accounting mismatch in the income statement.
- If a debt security had low credit risk at the date of initial application of IFRS 9, then the Bank has assumed that credit risk on the asset had not increased significantly since its initial recognition.

30. SUMMARY OF SPECIAL FUNDS

With the Hellenic Government

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

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Statement of movements		
Balance brought forward	8	29
Net income (loss) for the year	-	-
Less: disbursements	-	(21)
Balance of available funds	**8**	**8**
Financial position		
Placements with other financial institutions	8	8
Total Assets	**8**	**8**
Unallocated fund balance	8	8
Total Liabilities and Contributor Resources	**8**	**8**

With the Development Bank of Austria

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

Presented in EUR (000)	At 31 December 2017	At 31 December 2016
Statement of movements		
Balance brought forward	92	186
Net income (loss) for the year	-	(2)
Less: disbursements	(8)	(92)
Balance of available funds	**84**	**92**
Financial position		
Placements with other financial institutions	84	92
Total Assets	**84**	**92**
Unallocated fund balance	84	92
Total Liabilities and Contributor Resources	**84**	**92**

INDEPENDENT AUDITOR'S REPORT

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

Report on the Audit of the Financial Statements

Opinion

We have audited the financial statements of Black Sea Trade and Development Bank ('the Bank'), which comprise the statement of financial position as at 31 December 2017, the statements of income and other comprehensive income, changes in member's equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying financial statements present fairly, in all material respects, the financial position of the Bank as at 31 December 2017, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRSs).

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Bank in accordance with the ethical requirements that are relevant to our audit of the financial statements in International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (IESBA Code), and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Impairment Losses on Loans

Refer to pages 73 to 76 of the financial statements for a description of the accounting policies and to pages 88 to 93 for an analysis of credit risk.

<table>
<tr><th>Key audit matter</th><th>How the matter was addressed in our audit</th></tr>
<tr><td>
As described in the notes to the financial statements, the impairment losses have been determined in accordance with IFRS 9 Financial Instruments.

This was considered a key audit matter as IFRS 9 is a new and complex accounting standard which requires significant judgment to determine the impairment reserve.

Key areas of judgment included:
– The interpretation of the requirements to determine impairment under application of IFRS 9, which is reflected in the Bank's expected credit loss model.
– The identification of exposures with a significant deterioration in credit quality.
– Assumptions used in the expected credit loss model such as the financial condition of the counterparty, expected future cash flows and forward looking macroeconomic factors (e.g. unemployment rates, interest rates, gross domestic product growth, property prices).
– The need to apply additional overlays to reflect current or future external factors that are not appropriately captured by the expected credit loss model.
</td><td>
In assessing impairment reserve, we performed the following procedures:
– We assessed the modeling techniques and methodology against the requirements of IFRS 9.
– We assessed the design and tested the operating effectiveness of relevant controls over the:
  - Data used to determine the impairment reserve, including transactional data captured at loan origination, ongoing internal credit quality assessments, storage of data and interfaces to the expected credit loss model.
  - Expected credit loss model, including model build and approval, ongoing monitoring/ validation, model governance and mathematical accuracy.
– We assessed and tested the material modeling assumptions as well as overlays with a focus on the:
  - Key modeling assumptions adopted by the Bank.
  - Basis for and data used to determine overlays.
  - Sensitivity of the provisions to changes in modeling assumptions.
– We examined a sample of exposures and performed procedures to evaluate the:
  - Timely identification of exposures with a significant deterioration in credit quality.
  - Expected loss calculation for exposures assessed on an individual basis.
– We involved our IT specialists in areas that required specific expertise (i.e. data reliability and the expected credit loss model).
– We assessed the accuracy of the disclosures in the financial statements.
</td></tr>
</table>

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual report, but does not include the financial statements and our auditors' report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

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

In preparing the financial statements, management is responsible for assessing the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Bank or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Bank's financial reporting process.

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

– Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

– Obtain an understanding of internal control relevant to the audit to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control.

– Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

– Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Bank to cease to continue as a going concern.

– Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

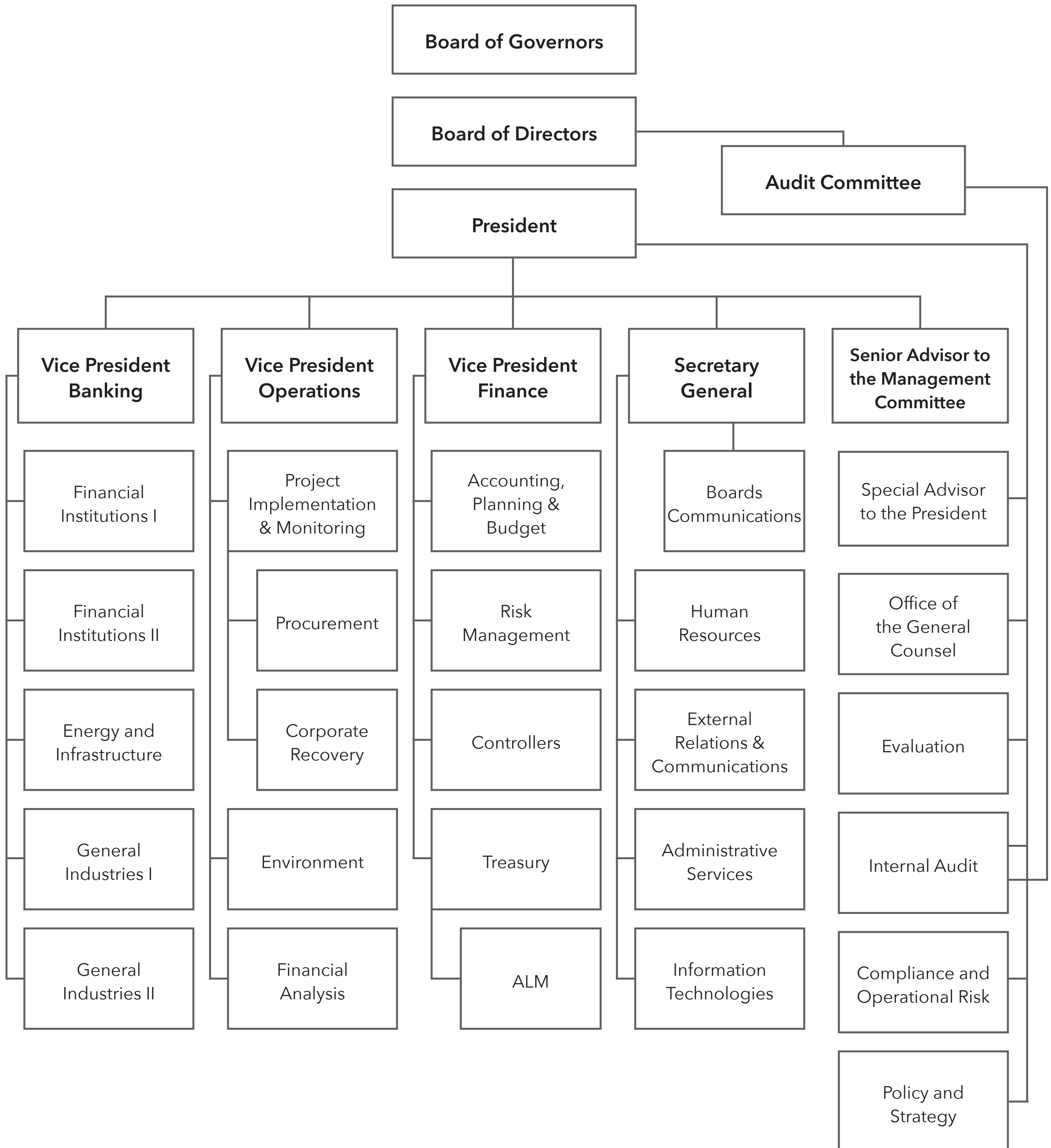
We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditor's report is Nikolaos Vouniseas.

KPMG Certified Auditors AE
Athens, Greece
15 June 2018

Organizational Chart



As of 31 December 2017

Annex B

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