Annual Report

Black Sea Trade And Development Bank

2008

Black Sea Trade & Development Bank

Annual Report Contents

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Board of Governors

As of 31 December 2008

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

Republic of Armenia
Governor:
Mr. Athrur Javadyan
Chairman
Central Bank of Armenia
Alternate Governor:
Mr. Vahe Vardanyan
Director, Financial sector Policy &
Analysis Department
Central Bank of Armenia

Republic of Azerbaijan
Governor:
Mr. Shahin Mustafayev
Minister of Economic Development
Alternate Governor:
Mr. Samir Sharifov
Minister of Finance

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

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

Hellenic Republic
Governor:
Mr. Ioannis Sidiropoulos
General Secretary
Ministry of Economy and Finance
Alternate Governor:
Mr. Konstantinos Kollias,
Special Secretary for Privatization
Ministry of Economy and Finance

Republic of Moldova
Governor:
Mr. Mariana Durlesteanu
Minister of Finance

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

Russian Federation
Governor:
Mr. Dmitry Pankin
Deputy Minister of Finance
Alternate Governor:
Mr. Dmitri Levchenkov
Director
Investment Policy Department
Ministry of Economic Development

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

Ukraine
Governor:
Mr. Bogdan Danylyshyn
Minister of Economy
Alternate Governor:
Mr. Anatoliy Shapovalov
First Deputy Governor
National Bank of Ukraine

Board of Directors

As of 31 December 2008

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

Republic of Armenia
Director:
Mr. Vardan Aramyan
Deputy Minister of Finance
Alternate Director:
Mr. Nerses Mkrtchian
Director of International Economic
Cooperation Department
Ministry of Foreign Affairs

Republic of Azerbaijan
Director:
Mr. Mikayil Jabbarov
Deputy Minister of Economic
Development
Alternate Director:
Mr. Rufat Mahmud
Head, Foreign Trade & Economic
Relations Department
Ministry of Economic Development

Republic of Bulgaria
Director:
Ms. Nina Stavreva
Head, Office of the Minister
Ministry of Finance
Alternate Director:
Ms. Gergana Beremska
State Treasurer
Ministry of Finance

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

Hellenic Republic
Director:
Mr. Dimitrios Giannos
General Director for International
Economic Policy
Ministry of Economy and Finance
Alternate Director:
Ms. Zoe Driva Evangelopoulou
Director, Administration
Ministry of Economy and Finance

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

Romania
Director:
Ms. Diana Peligrad Blindu
Head Operations I
General Directorate for Treasury &
Public Debt
Ministry of Economy & Finance
Alternate Director:
Mr. Stefan Petrescu
General Director
General Directorate for External
Public Finance
Ministry of Economy & Finance

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

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

Ukraine
Director:
Mr. Valeriy Pyatnytskiy
Deputy Minister of Economy
Alternate Director:
Mr. Volodymyr Lytvyn
Deputy Minister of Finance

Audit Committee

As of 31 December 2008

Chairperson:
Ms. Diana PELIGRAD BLINDU
BSTDB Director for Romania

Members:
Mr. Nezir HALDEDA
BSTDB Director for the Republic of Albania

Mr. Vardan ARAMYAN
BSTDB Director for Republic of Armenia

Ms. Ina GOREA
BSTDB Director for the Republic of Moldova

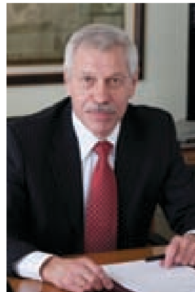
Management

As of 31 December 2008

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

Andrey Kondakov
Vice President Banking

Sophia Kassidova
Vice President Finance



Vitalii Mygashko
Vice President Operations

George Kottas
Secretary General

To the Board of Governors

In accordance with Article 35 of the Agreement Establishing the Black Sea Trade and Development Bank and Section 10 of its By-Laws, I submit to the Board of Governors the Bank's Annual Report 2008 as endorsed by the Board of Directors.

The Tenth Annual Report also contains the Bank's financial statements, including a separate financial statement for the operations of its Special Fund, as prescribed in Section 12 of the Bank's By-Laws.

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

Statement by the President

As with the economy of the Black Sea Region, so with the Black Sea Trade and Development Bank, a review of 2008 must be divided into two parts, the pre-crisis period and the crisis period. For the Region, the first period was a continuation of the uninterrupted economic growth since 2000. The momentum of previous years, during which real GDP growth averaged more than 6% per annum, extended into the first part of 2008. There were more fears that the economies of the Region might be overheating than that the financial crisis originating in the US might endanger continued economic expansion in the Region. The second period, however, quickly reversed this. The severe financial crisis that broke out in late September brought about a near total collapse of credit markets globally. Access to financing dried up and risk aversion rose to panic heights. The resulting contagion swiftly impacted the Black Sea Region, causing a sharp halt to growth, economic crisis and credit rating downgrades. The close of 2008 saw the Black Sea economies trying to cope with the effects of this crisis, to shore up their fiscal balances and financial systems, and to navigate through a period of economic uncertainty.

For the Bank, 2008 began largely as 2007 had ended, with the operational portfolio expanding rapidly as demand for Bank services and products was buoyant. Over the first half of 2008, 20 new operations amounting to SDR 248 million were approved by the Bank's Board of Directors (BoD) and 28 operations amounting to SDR 278 million were signed. During this period, the amounts disbursed and outstanding increased 24% over the end of 2007 figure, to SDR 587 million.

However, signals of market deterioration including rising spreads, greater difficulty in accessing capital, and above all increased uncertainty in market conditions forced the Bank to slow down its pace of expansion in order to stay informed amid extremely fluid conditions and avoid making mistakes. Instead, the Bank turned its attention to safeguarding its portfolio, fortifying relationships with clients and seeking ways in which to provide value to shareholders. Portfolio expansion slowed, such that only one new operation was approved by the BoD and two were signed during the second half of the year. Consequently, overall portfolio growth also slowed, and for the year commitments show an increase of 17% to SDR 739 million while the amounts disbursed and outstanding grew to SDR 617 million, an increase of 30% on end–2007 figures.

In early October, the Bank's Board of Governors (BoG) followed up on its decision to double subscribed capital to SDR two billion in December 2007 by subscribing fully and allocating the new BSTDB shares in the amount of SDR one billion that had been offered. Undoubtedly the pinnacle event of the year for the Bank, it underscored the strong commitment of the Bank's shareholders to its mission to promote regional cooperation and economic development, and emphatically stressed their confidence in the Bank's achievements and its prospects. Unfortunately, it also coincided time-wise with the most precarious and difficult week for credit markets globally, in which financial systems worldwide nearly suffered a meltdown.

The extraordinary crisis overshadowed not just this accomplishment, but also a number of other highlights that made 2008 a highly successful year for the Bank. Despite the worsening financial conditions, BSTDB demonstrated its ability to mobilize resources for the Region and its attractiveness to external financiers in securing the largest syndicated loan in its history in September, for SDR 238 million on favorable commercial terms. And amid the global turmoil, the Bank achieved robust results for the year. Income before provisions increased 18% relative to 2007 to SDR 17.5 million, while net profit rose 44% relative to 2007 to SDR 13.1 million.

The Bank developed further its partnerships with other national and international financial organizations (IFIs) with an interest in the Black Sea Region by granting Observer Status to the European Investment Bank (EIB), the Nordic Investment Bank (NIB), the Development Bank of Austria (OeEB), and the Association of the European Development Finance Institutions (EDFI). In the case of OeEB, cooperation extended to the establishment of a Technical Cooperation Special Fund administered by BSTDB in the amount of EUR 500,000 for the provision of a broad array of technical assistance and training needs.

The achievements of 2008 provide a solid foundation upon which to build in 2009, the 10th Anniversary year of operations for BSTDB. On the one hand, fallout from the crisis continues to be unfavorable, raising the levels of uncertainty and reducing the appetite for economic activity and new initiatives in the Region. On the other hand, this leaves a greater opening for international financial institutions such as the Bank to play a ‘counter-cyclical role’, so as to be able to assist clients to obtain recourse to solutions in a constrained international setting.

Although the Bank places high priority on maintaining the excellent quality of its operations, it will continue its strategy of managed expansion in 2009 in order to meet growing regional requirements. This strategy will seek to maintain a due emphasis on smaller regional countries, an improved balanced of portfolio development across larger countries, and where possible a shift in emphasis to more multi-country operations that have higher regional cooperation impact. Cooperation with IFIs, donors and other external actors will also be an important tool for responding to the current crisis and therefore, in addition to greater own resource mobilization for the benefit of regional economic actors, the Bank intends to increase co-financing with its expanding group of partner organizations.

The Bank’s successful development in recent years has been predicated on responsiveness and adaptability to client requirements in the evolving business environment of the Black Sea Region. The nature of the response in current circumstances will likely involve a turn towards ‘traditional’ financing in the form of straight lending, investment, and provision of guarantees, to support clients in their efforts to cope with, and overcome, the challenges of the crisis. For their part, these clients have demonstrated tremendous determination despite the virulence of the downturn, and the countries of the Region have similarly shown considerable resilience, drawing upon reservoirs of experience and policy flexibility to staunch the worst effects and set the stage for a return to economic growth.

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

Highlights of 2008

• Following a decision to increase the BSTDB authorized capital three-fold, to SDR 3 billion, and to double the subscribed capital to SDR 2 billion (appx. USD 3 billion), new BSTDB shares in the amount of SDR 1 billion offered for subscription to the 11 Bank's shareholding states have been fully subscribed and allocated. The final decision on subscription and allocation was taken by a Special Meeting of the BSTDB Board of Governors held in October 2008. The shareholders expressed their full support for the Bank and its mission to promote regional cooperation and economic development in its member countries. They confirmed their strategic commitment to enlargement of the Bank's membership by attracting new regional members and internationally reputed multilateral banks and financial institutions.

• The Bank demonstrated a strong financial performance in 2008 with operating income before provisions increased by 18%, from 2007, to SDR 17.5 million, while net profit rose 44% relative to 2007, to SDR 13.1 million.

• Outstanding operations increased by 30% to a total of SDR 617 million (USD 950 million) while 30 new operations were signed in 2008 for a total of SDR 298 million (USD 459 million). The Bank ended the year without any new non-performing loans.

• Business development in smaller member countries remained an operational priority in 2008, resulting in an increase of over 22% in signed operations in this group of countries. A particular success was achieved in Albania, which saw its share of the Bank's portfolio increase from 0.5% in 2007 to 5% in 2008.

• Four major national and international financial institutions, each actively involved in assisting economic development in the Black Sea Region, namely: the European Investment Bank (EIB), the Nordic Investment Bank (NIB), the Development Bank of Austria (OeEB), and the Association of the European Development Finance Institutions (EDFI), were granted BSTDB Observer Status joining the KfW Banking Group of Germany. The Observer Status provides a mechanism for regular contact and exchange of information with the objective of promoting co-financing and joint activities in the Region.

• Within the framework of its Observer Status with BSTDB, the Development Bank of Austria - OeEB - established a Technical Cooperation Special Fund, administered by BSTDB, with an initial contribution of EUR 500,000. This is an untied facility offering financing for a wide range of technical assistance services and training needs for BSTDB clients in the countries of the Black Sea region. The Special Fund represents the first financial facility of this kind provided to BSTDB by a non-regional institution.

• BSTDB raised USD 325 million and EUR 20 million through a syndicated loan facility in September 2008. Bayerische Landesbank ("BayernLB"), Emirates NBD PJSC ("Emirates NBD"), Intesa Sanpaolo S.p.A. ("ISP") and Sumitomo Mitsui Banking Corporation Europe Limited ("SMBCE") acted as lead arrangers for the facility. Despite difficult market conditions, the Facility was extremely well received, increasing substantially from the initial launch amount of USD 60 million and EUR 20 million and drawing the participation of 31 banks from across the globe.

• BSTDB held the Annual Meeting of its Board of Governors in St Petersburg, Russia. Key decisions taken by the Board included the Member States' contributions to the agreed capital increase, election of the Governor for Greece as the new Chairman of the Board and decision to hold the next BSTDB Annual Meeting on 14 June 2009, in its home city of Thessaloniki, on the occasion of the Bank's 10th anniversary.

Economic Overview of the Black Sea Region: Trends in Development, Investment and Trade

Development Overview:
Trends During 2008 in the Black Sea Region
Trends During 2008 for “Smaller” Black Sea Region Economies
Investment, the Business Environment and Trade in the Black Sea Region

Development Overview: Trends During 2008 in the Black Sea Region[1]

For the greater Black Sea Region, defined here as the Member States comprising the Black Sea Economic Cooperation (BSEC), 2008 was a tale of two different periods lumped within the same calendar year. The first period, which ran from the beginning of the year into September, was the longer one time-wise, but quickly became a distant memory after the near total collapse of financial markets globally during the last week of September. This heralded the start of the second period, the impact of which began in the last quarter of 2008 and has extended into 2009.

Entering 2008, the Black Sea Region was riding a boom period that dated all the way back to 2000. From 2000–2007, the Region enjoyed average annual real GDP growth of 6.2%, equivalent to a 61% increase in the collective size of its economies, in real terms. For 2007, despite the onset of the US financial crisis, regional GDP growth was a robust 6.9%. As a result, and since the strong growth had continued into 2008, there were hopes that the Black Sea Region –like other economies outside the US and western Europe considered for the most part to be 'Emerging Markets'– had 'decoupled' from developed economies. That is, these economies had broadened and deepened to the point that they no longer depended on the United States or western Europe for growth, leaving them insulated from the severe slowdowns observed in developed economies. Because these economies enjoyed healthy macroeconomic indicators such as current-account surpluses, low sovereign debt levels, ample foreign reserves, and either positive or near balanced budgets, this would offer a cushion permitting them to make full use of monetary and fiscal policy to protect their economies and avoid the negative fallout from the US financial crisis.

To be sure, there were concerns about where the global financial crisis might lead; as the crisis broadened beyond the US sub-prime mortgage lending sector into other sectors within the US financial system and then over to western Europe, there was uncertainty about the eventual impact of the crisis upon the Black Sea Region. However, rather than being the predominant concern, it represented one more area of concern, alongside (and possibly behind) other areas of worry such as rapidly rising energy and commodity prices which were increasing inflationary pressures, and more general worries about indications of overheating in certain economies.

The global crisis that broke out with astonishing swiftness and impact in late September brought about a near total collapse of financial markets worldwide. Suddenly, access to financing dried up and risk aversion rose to panic heights. Instead of any 'decoupling' between the developed markets of the West and the rest of the world, the highly globalized nature of markets was observed, with immediate contagion which brought growth in the Black Sea Region to a halt and now threatens to reverse years of economic progress.

Thus, while the trend of growth from 2000–2007 continued for the first three quarters of 2008, with regional output increasing at an average real rate in excess of 6.0%, the sharp slowdown in the last quarter lowered outturns considerably – to an estimated 4.3% for the year (see figure 1).

Despite the slowdown, the Black Sea countries managed to maintain a milestone, achieving positive growth in each and every country for the seventh consecutive year (dating back to 2002). In most cases, the rate of growth was diminished relative to immediately previous years, and for all countries growth rates fell to near zero or even turned negative in the final quarter of the year as the financial crisis impacted the Region's economies while also evolving into a global economic recession. Whereas three Black Sea countries achieved double digit real GDP growth in 2007, only one just managed to repeat the feat in 2008.

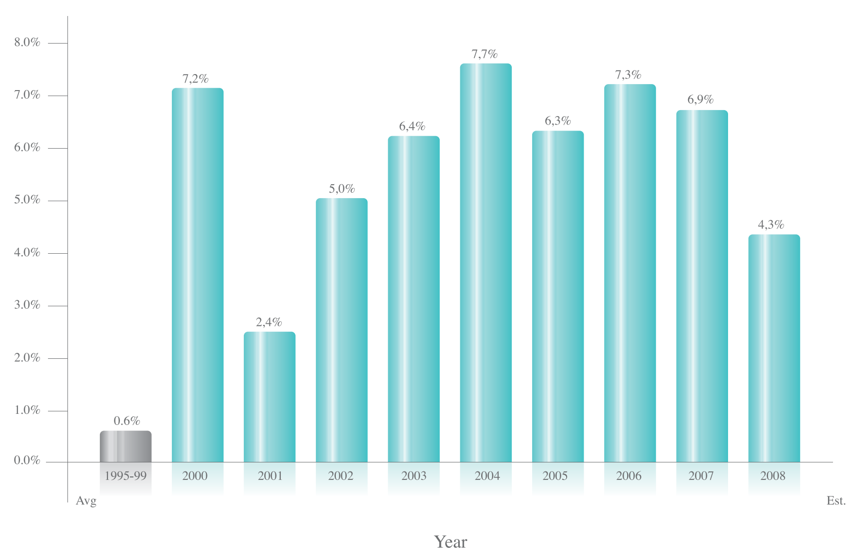


Figure 1: Black Sea Region Growth Trends 2000–2008

[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 2009 of the World Bank (& GEP 2008), the IMF's World Economic Outlook publications (and their updates) and the Economist Intelligence Unit. As many figures represent estimates for 2008, actual final figures may differ in detail, but the overall trends discussed in this section would not be altered.

Table 1 shows the growth rates achieved by BSEC countries in 2008, as well as certain other key macroeconomic indicators. Due to volatile energy prices and sharp increases in food prices during the first period of 2008, average annual inflation rates across the board were higher in 2008 than in 2007. This is underscored by the fact that whereas only three countries had double digit inflation rates for 2007, fully eight were in double digits in 2008. Conversely, only two had inflation rates below 5% in 2008, as opposed to four in 2007. With the onset of the economic crisis and the collapse of many commodity prices (including for energy), inflation rates declined during the last quarter of 2008, even as other key macroeconomic indicators worsened. The decline in economic activity resulted in a reduction in government revenues which in turn led to an increase in fiscal deficits for most countries, particularly as expenditures are more difficult to cut and run the risk of aggravating the effects of the economic slowdown.

	GDP Growth	Avg. Inflation	Budget / GDP	Cur Acct Bal/ GDP
Albania	6.0%	3.4%	-5.4%	-16.5%
Armenia	6.8%	9.0%	-1.2%	-13.1%
Azerbaijan	10.8%	20.8%	-6.4%	36.5%
Bulgaria	6.0%	12.4%	2.8%	-23.5%
Georgia	2.1%	10.0%	-1.8%	-23.4%
Greece	2.9%	4.2%	-3.8%	-14.5%
Moldova	7.2%	12.8%	-1.0%	-19.0%
Romania	7.1%	7.9%	-5.4%	-12.4%
Russia	5.6%	14.1%	4.8%	6.1%
Serbia	5.4%	10.9%	-2.5%	-17.7%
Turkey	1.1%	10.1%	-1.7%	-5.6%
Ukraine	2.1%	25.2%	-1.5%	-7.2%

Table 1: Summary of Key Economic Indicators for 2008, by BSEC Member Country

The current account situation of most countries also deteriorated, and while the absolute numbers became more negative, a more worrying trend was a shift in the nature of this deficit. As foreign direct investment accelerated in 2006 and 2007 across the Region, investors increased the importation of intermediate inputs such as machinery and key commodities. Thus, a sizeable portion of the current account deficits was the result of a desirable process of investment for greater output growth and creation of wealth. Other types of capital inflows (such as borrowing from abroad and portfolio investment) had also increased and contributed to the increased importation of intermediate inputs and levels of investment more generally, although these had also fueled increased importation of consumption and other final goods. However, import growth rates were matched and sometimes exceeded by export growth rates, implying that countries were improving their productive capacity and their competitiveness in certain sectors. The onset of the economic crisis resulted in a sudden decline in demand globally and this impacted exports adversely, particularly because recession-hit western Europe has evolved in recent years into an evermore important trade and investment partner for the Black Sea Region, and the contraction there reduced exports from the Black Sea Region, as well as capital inflows to the Region.

One irony of the onset of the recession, is that it put to rest growing concerns during 2007 and into 2008 about the possibility of overheating of various economies of the Region. The years of sustained growth since 2000 had followed difficult periods of structural reform and macroeconomic stabilization in the late 1990s. However, as growth continued, certain aspects of 'boom' economies began to appear, including: (i) rising asset prices – especially property values in major urban centers; (ii) sharp increases in domestic and external lending; (iii) upswings in inflation rates; (iv) increased pressures on government budgets – particularly on the expenditure side; and (v) expanding current account deficits.

While these indicators represented cause for concern, they did not portend an end to growth, nor imminent economic reversal. Certain corrective measures were increasingly viewed as necessary, including greater fiscal restraint, re-allocation of expenditures, tighter monetary policy, closer regulation of financial institutions, and structural reforms to eliminate distortions in certain sectors of the economy. Moreover, as the track record of the Region's economies in tackling such problems had been positive in recent years, there was increased confidence in its resiliency and ability to handle emerging problems.

The global financial crisis eliminated these concerns virtually overnight. Instead, the virulence with which it impacted the Black Sea Region resulted in a sharp halt to growth, economic crisis and credit rating downgrades. The global financial crisis very quickly became a Region-wide economic crisis, affecting all Black Sea economies, but especially hitting those viewed as most vulnerable, with vulnerability determined by the apparent need for continued inflow of foreign capital. Since external financing had suddenly become scarce to the point of non-existence, factors such as a sizeable current account deficit, a large foreign debt, or high levels of foreign borrowing suddenly became perceived as intractable weaknesses.

Instead of any notion of decoupling, there was a strict re-affirmation of a hierarchy of access to financing based upon perceptions of country risk which were determined by a combination of credit ratings, levels of development, and overall economic size. Among sovereigns, the United States emerged as the country with the easiest and cheapest access to financing, despite being the origin of the crisis. Despite interest rate cuts and a sharp loosening of monetary policy, investors flocked to purchase American

debt as a 'safe haven' in the midst of extreme market conditions, highlighting the dollar's status as the principal global reserve currency.

The reinforcement of the hierarchy of access to financing has resulted in a sort of financial food chain, in which the highest rated enjoy the best seat at the table, at reduced prices no less, while the lower rated remainder scramble for what is left over and must pay more for the 'privilege'. Among those scrambling are the economies of the Black Sea Region, which has one country rated single A, three others clinging to lower end investment grade ratings, and eight sub-investment grade sovereigns.

An additional problem is that the immediate needs of the economic crisis may reschedule activity in other areas which are important for the long term growth of the Region's economies. The need for structural reforms in sectors such as energy and agriculture is common to many countries, yet such reforms are often as difficult as they are necessary. The impact of the crisis on these sectors is uncertain, as it may offer an opportunity for reforms, or it may cause delays, depending on specific circumstances.

The threat to the existing state of infrastructure is much clearer and more worrying. Improvements in infrastructure quality and capacity have lagged behind the private sector led economic boom from 2000–2007, coming under increasing strain as flows of goods, services and people have rapidly increased. Infrastructure development is inherently costly and time consuming, requiring lengthy periods for planning and execution. Prior to the crisis, the fiscal situation of Black Sea countries, although much improved, was still unable to meet the large new infrastructure requirements. In the context of crisis, revenues have decreased and will continue to do so, while spending pressures remain, thus threatening sharp deterioration in fiscal balances in an already difficult environment. Where possible, therefore, spending cuts are highly likely and historically infrastructure and other capital expenditures are likely to be among those postponed or cancelled, as they are easier to reduce than are non-discretionary expenditures such as debt servicing obligations, civil servant salaries, and pensions and insurance. However, such cuts would risk adversely impacting the long term growth potential of the economies.

As a first step, restoration of credit flow to the Region represents a critical element to recovery from the crisis, definitely necessary but most probably not sufficient. Yet even this is a huge stumbling block for Black Sea countries since they find themselves at the lower end of the financial food chain and most lack a currency with reserve status. Like other emerging markets and lower rated borrowers, they face the real threat of being crowded out of credit markets by the record volumes of borrowing planned by higher rated developed economies who in turn intend to reverse economic decline and stimulate their economies. At a minimum, the increased competition for available funds will result in higher interest rates for emerging market issuers, and the lower a rating that a country carries, the higher the costs that it will face.

With markets dysfunctional and mispricing country and other risks, official sources of financing represent the sole option for Black Sea countries. In contrast to the United States or western Europe, Black Sea countries are unable to take measures sufficient so as to re-open lending. The economies are too small and open for capital injections to achieve the required degree of stimulus. Moreover, their currencies lack reserve currency status and as such they are unable to inject sufficient liquidity into their financial systems without drawing down reserve levels and risking severe capital flight or even collapse.

This is where external support has a vital role to play in two broad forms. First, at the level of policy coordination, it is essential that measures to support banking systems and revise regulation incorporate countries from the Black Sea Region which are interested in participating. Ideally, financial system support programs would take place under a coordinated framework. The framework would seek to deal with issues systemically and comprehensively without generating "insider/outsider" problems, where measures taken to improve the situation for 'insider' countries (those included in the scheme) end up creating even greater challenges for 'outsider' countries (those outside the scheme). A useful rule of thumb in so doing, would be to ask whether the measure in question reduces uncertainty, and if it does, is it reducing uncertainty across the board, or is it shifting the uncertainty to other parties.

The second form of external support involves increasing official sector lending in order to help jumpstart the flow of credit. The family of international financial institutions is well placed to operate in the needed counter-cyclical manner to help increase the flow of credit to eligible countries. National development financial institutions and other bilateral official sources of lending may play a similar role.

External assistance in the form of (i) official sources of financing and (ii) coordinated financial policy support could act as first steps to help restore access to credit and permit the countries of the Black Sea Region to utilize solid macroeconomic fundamentals such as higher foreign reserve levels, low external public debt and reasonably solid fiscal pictures so that at a second stage they can mitigate economic damage from the crisis domestically and seek solutions that will assist a turnaround.

Development Overview: Trends During 2008 for "Smaller" Black Sea Region Economies

Despite the sharp reduction in growth in the greater Black Sea Region, its overall performance for 2008 remained among the higher rates globally (see figure 2). Black Sea regional growth was four times higher than that of the 27 European Union countries (including Bulgaria, Greece, and Romania) which as a whole experienced estimated growth of 1.0%, while the Eurozone's 15 members (including Greece) experienced growth of 1.1%. This is significant, because in recent years the EU–27 has grown significantly as a trading partner and a source of financing and investment for the Black Sea Region. Regional growth also outpaced that of neighboring regions such as the 2004 EU Entrants from Central-Eastern Europe and the Baltics[2], who are often used as comparators since, like most Black Sea countries, they underwent a transition process from centrally planned to market oriented economies. Overall, the Black Sea Region grew at nearly twice the rate of growth of the World Economy, although it lagged somewhat relative to other developing regions, which enjoyed estimated growth of 6.3%.

The 'smaller' countries[3] of the Black Sea Region continued to enjoy strong growth relative to the rest of the Region. In addition to smaller population and economic size, these countries have larger development needs and higher poverty rates in comparison to the rest of the Black Sea Region. They suffer disproportionately greater perceptional problems in terms of their perceived prospects and risks, and generally underwent difficult periods of 'transition' from centrally planned economies to market oriented economies. In the past they have been defined as countries which: (i) have national populations under 10 million; (ii) national GDP under USD 40 billion; and (iii) per capita incomes under USD 4,000. However, such has been their performance in recent years, that as of 2008 one country exceeds the national GDP criterion, and two exceed the per capita income criterion[4]. A trend observed since 2005, with the smaller economies enjoying rates of growth double those of the rest of the Region, was repeated in 2008. Even though the smaller economies experienced a slowdown compared to the frenetic, often double digit growth, of the immediately preceding years, they still achieved an average real GDP growth rate of 8.1%. Since 2000, the smaller economies have grown over 150% in real terms, and since 2005 in particular, their annual growth rate has been double that of the rest of the Region (or even higher).

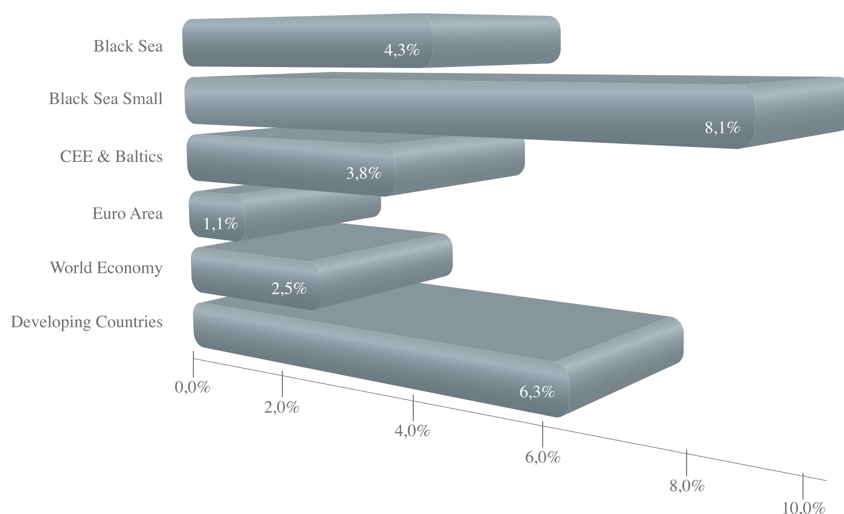


Figure 2: Comparison of Global GDP Growth for 2008, by Select Region

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

Notwithstanding the economic crisis, for 2008 income levels across the Region continued to show growth in line with previous years (see figure 3). While such figures have limitations, and may be affected by exchange rate fluctuations from year to year, over an extended period they do reveal a genuine rise in overall living standards throughout the Region. They are also supported by parallel improvements in other indicators, including average wage levels which have increased notably, and non-economic indicators such as declining poverty rates, improving life expectancy, increasing consumption rates, etc.

Per capita incomes have increased nearly four and a half times in dollar terms over eight years from roughly USD 2,300 in 2000 to an estimated USD 10,300 in 2008. The figures for small countries are even sharper, as per capita income has risen from approximately USD 750 in 2000 to USD 4,300 in 2008. In the process, the smaller country income levels have converged somewhat. Despite the very high overall regional increases, the average per capita income of smaller countries rose from 33% of the regional average, to 42% during this period, yet again underscoring their exceptional growth.

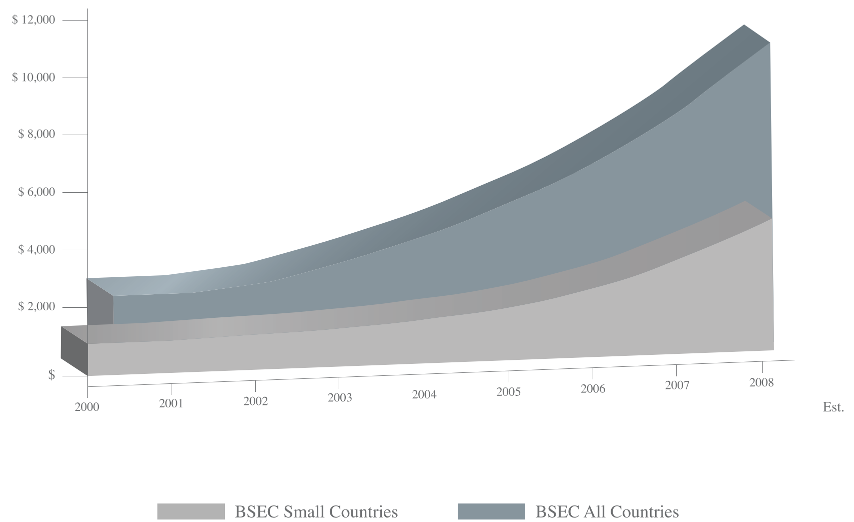


Figure 3: Black Sea Region Per Capita Income Patterns 2000–2008

Investment, the Business Environment and Trade in the Black Sea Region

Foreign direct investment (FDI) represents a key indicator of external interest and confidence, as well as an indicator of the overall business environment. It is a useful proxy for gauging external perceptions of the Region, and for the nature of economic activity. Historically, the Black Sea Region lagged behind other transition and emerging economies –such as those of Central and Eastern Europe and the Baltics– in the amount of FDI that it attracted, both in absolute terms but especially as a share of the size of the economy. After languishing at levels around 1.0% of GDP through much of the 1990s and into the early 2000s, the economies of the Black Sea began to attract soaring amounts of FDI starting in 2003 and through 2007 (see figure 4).

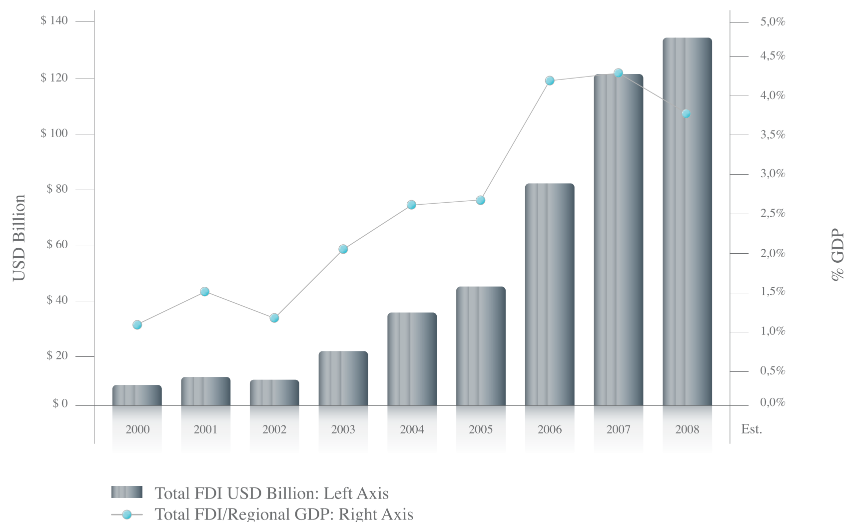


Figure 4: Foreign Direct Investment in the Black Sea Region 2000–2008

This trend continued into 2008, as high local growth, proximity to wealthy markets in western Europe, an improved business climate, the high receptiveness for foreign investment all combined to create a highly favorable environment for FDI, together with increasingly sophisticated and cheap financing. The onset of the global financial crisis and consequent regional economic crisis slowed the trend in the last quarter of 2008. Thus, while record levels of FDI amounting to USD 131 billion were reached in absolute terms, the number would surely have been higher in the absence of the crisis as there is strong evidence that investment plans were delayed and even abandoned as financing conditions worsened sharply. In the event, FDI levels in 2008 as a share of GDP came to 3.9%. While still robust, this represents a decline relative to 2006 and 2007 when GDP as a share of the regional economy had reached 4.2% and 4.3% respectively. It also suggests that FDI as high as USD 150 billion might have been achieved in the absence of the crisis.

[3] Albania, Armenia, Azerbaijan, Georgia, Moldova.

[4] Azerbaijan's estimated national GDP in 2008: USD 46.3 billion. Estimated per capita income in 2008 for Azerbaijan: USD 5,300; for Albania: USD 4,100.

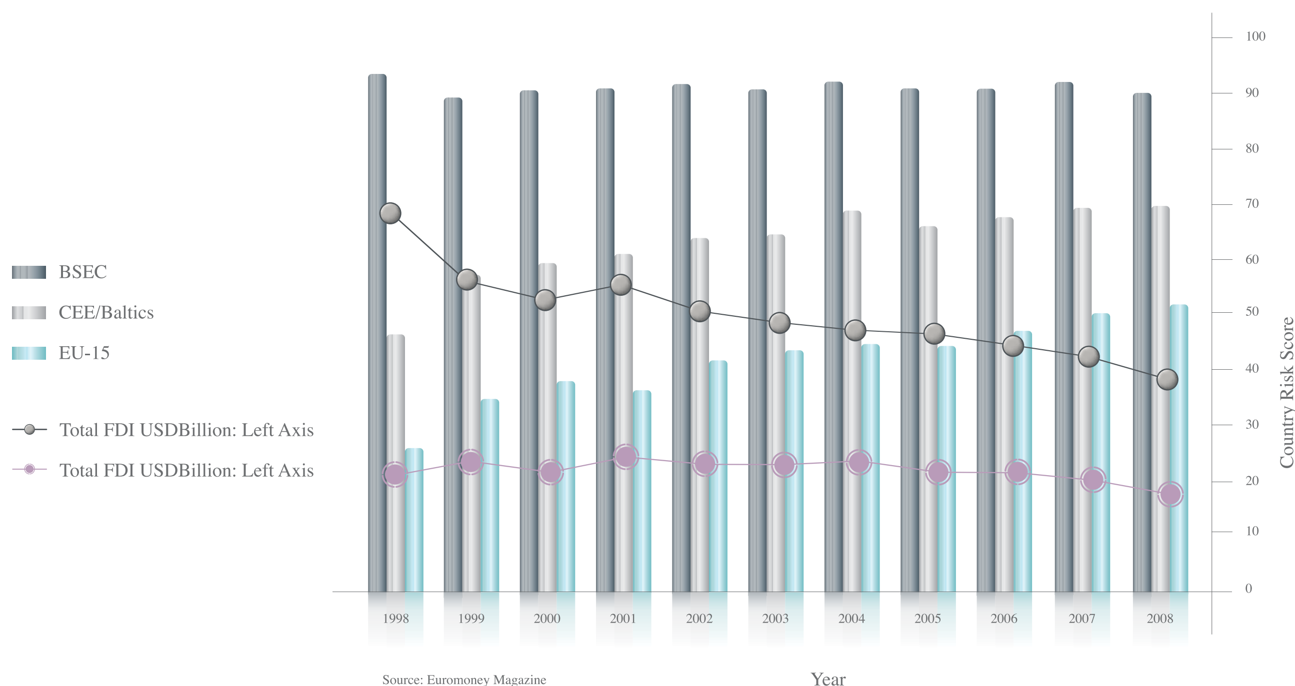


Figure 5: Trends in Regional Euromoney Country Risk Scores & Relative Differences[5]

Figure 5 shows the evolution of country risk scores for the Black Sea Region according to Euromoney magazine, which has one of the longest established and most frequently quoted/referenced indices of country risk published twice per annum. According to this index, updated through 2008, the Black Sea Region has for a decade demonstrated consistent improvement in its average country risk score each year, and has managed to reduce the gap between itself and the original EU–15 members, who are generally considered to have among the most favorable country risk scores globally.

Both in absolute terms relative to previous years, and in comparison to the EU-15, there is tangible improvement, although there is also a long way still to go. A particularly notable feature of regional country risk is that it has also shown a degree of convergence in comparison to the country risk scores of the eight Central & Eastern European and Baltic countries (CEE & Baltics) that joined the EU in 2004. The CEE & Baltics countries experienced a strong boost from their accession to the EU in 2004, and have maintained more favorable country risk scores than the Black Sea Region countries. However, the Black Sea countries have matched the year to year improvement, and have even managed to reduce the gap between themselves and the CEE & Baltics countries, even though they have less scope to improve their country risk standing as a result of EU accession, given that the Black Sea Region has six non–EU candidates, one candidate for EU membership, two potential EU candidates, and only three EU members.

Other indicators and indices of country risk have shown similar improvement over the years, whether they concern country risk per se, or specific features of country risk such as ease of doing business, quality of governance, degree of market orientation (or ‘economic freedom’). Long term sovereign credit ratings, which represent confidence in the creditworthiness of countries, are yet another indication of these improving perceptions. Since these ratings incorporate elements of country risk within their calculation, albeit to differing degrees among the rating agencies, they represent an easily recognizable measure of a significant component of country risk.

The economic crisis of 2008 led to credit rating downgrades globally, and the countries of Eastern Europe and the Black Sea Region were particularly hard hit since they were perceived to be particularly vulnerable due to: (i) their proximity, linkages, and consequent economic interdependence with western Europe that is already in recession with negative growth; and (ii) especially heightened perceptions of vulnerability deriving from rising current account deficits in many Black Sea countries and the expected difficulty they may encounter in attracting external financing in the current highly risk averse environment that characterizes global markets. Notwithstanding the deterioration in the global markets and its detrimental impact on perceptions of risk in the Black Sea Region, four Black Sea countries currently possess ‘investment grade’ sovereign credit ratings, and all have ‘entered the market’ and received at least one sovereign rating from one of the three main credit rating agencies, which is in itself an indication of the progress and maturation of their economies, and the desire to establish access to global capital markets, and establish benchmarks to deepen domestic markets. In 2000, only one Black Sea country enjoyed an investment grade rating, and five had not even bothered to obtain credit ratings.

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

	December 1999			December 2008		
	Moody's	S&P	Fitch	Moody's	S&P	Fitch
Albania	—	—	—	B1	—	—
Armenia	—	—	—	Ba2	—	BB
Azerbaijan	—	—	—	Ba1	—	BB+
Bulgaria	B2	B+	B+	Baa3	BBB	BBB-
Georgia	—	—	—	—	B	B+
Greece	A2	A-	BBB+	A1	A	A
Moldova	B2	—	B-	Caa1	—	B-
Romania	B3	B-	B-	Baa3	BB+	BB+
Russia	Ca	SD	CCC	Baa1	BBB	BBB+
Turkey	B1	B	B+	Ba3	BB-	BB-
Ukraine	B3	—	—	B1	B	B+

Table 2: BSTDB Sovereign Credit Ratings Comparison 1999 vs. 2008

Turning to trade in the Black Sea Region, international trade flows can reveal how trade among countries is evolving over time, and certain emerging trends. Lags in the collection of external trade data do not permit for presentation of 2008 data, which may show sharp differentiation relative to previous years as a result of the onset of the economic crisis which has affected global trade patterns, and will certainly impact regional commerce as well. Despite this and other inherent limitations[6], recorded trade figures over a suitable period of time can suggest certain patterns, or raise theories and questions for further research.

In the case of the Black Sea Region, during the course of the 2000s decade, there appears to be a gradual trend of increasing trade among Black Sea countries.
Figure 6 displays how intra-Black Sea trade is evolving as a share of total trade, as well as how intra-Black Sea trade is evolving as a share of GDP. The first indicator measures the extent to which trade among Black Sea countries is increasing relative to the external trade of Black Sea countries. It provides insight into the orientation of the external trade of Black Sea economies and how internal regional trade compares with commerce with non-regional countries. The second indicator offers more general information about how intra-Black Sea trade is evolving with respect to, and its relative importance to, the overall size of the Black Sea economies.

Recorded trade among Black Sea countries in dollar terms increased 505% in value between 1999–2006 from USD 38.4 billion to USD 232.6 billion. This figure is likely inflated by factors such as increased energy and other commodity prices as well as the decline in the value of the dollar over this period, but it still exceeds the increase in the nominal GDP of the Black Sea Region in dollar terms over the same length of time, which increased 305%. It also exceeds the rate of increase of total international trade of Black Sea countries, which increased 359%, from USD 282.52 billion to USD 1,298 billion.

Trade within the Black Sea Region (i.e. exports and imports among the Black Sea countries) has risen from an estimated 13.6% of total trade in 1999 to 17.9% of total trade in 2007. As a share of total regional GDP, trade among Black Sea countries has risen from 5.6% in 1999 to an estimated 8.4% in 2007. Thus, both measures in Figure 6 show a gradually rising trend over time, and suggest that the pace of trade among Black Sea countries has picked up.

While the overall numbers remain low relative to other regions around the globe (e.g. around the Baltic Sea), a nascent movement toward greater integration and trade with regional partners is discernible. However, the figures suggest that in comparison to other regions, there is still considerable room for further increases in intra-regional trade levels.

The growth is not evenly distributed among countries, with Turkey having most vigorously increased its trade levels with other Black Sea countries during this period. Other countries for which intra-BSEC trade as a share of GDP have shown particularly high increases between 1999–2007 include Bulgaria, Georgia, Greece, Romania, and Serbia. Interestingly, all but Georgia are so called EU 'Ins'- Bulgaria, Greece and Romania are EU members, Turkey is a candidate for accession, and Serbia is a potential candidate that is pushing its application. By way of contrast EU 'Outs'–countries without an EU membership perspective and/or interest in the EU– have shown smaller increases in the level of intra-BSEC trade, and in some cases trade with non-regional partners has grown more rapidly.

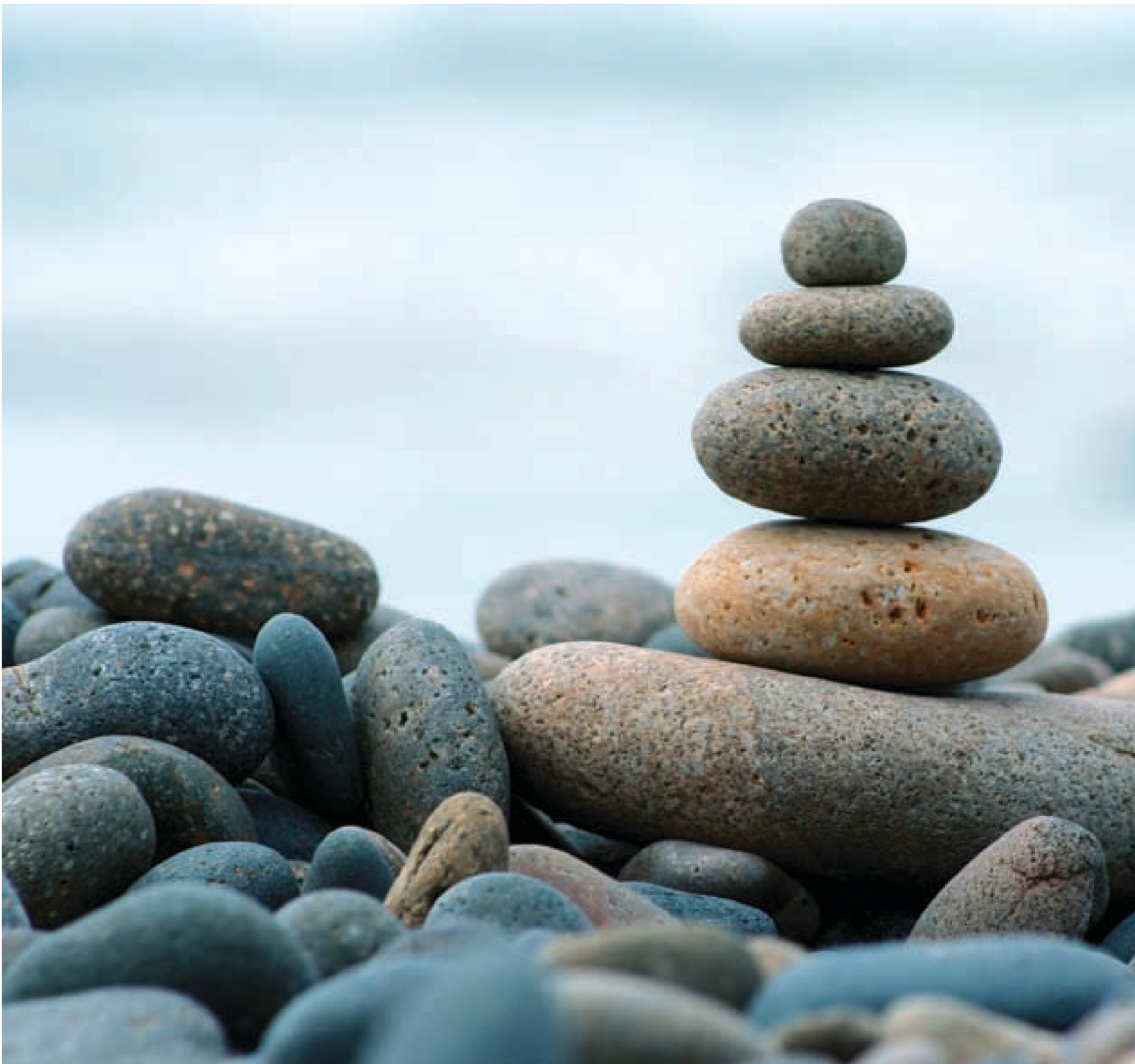
This raises interesting hypotheses about the importance of the EU in helping to shape trade patterns in the Black Sea Region, versus other influences such as historical links and geography. Disruption of global trade as a result of the crisis in 2008 will also need to be considered, not least how it may affect not only overall flows, but also the re-orientation of commerce in the Black Sea Region internally, where it has displayed growth in a steady but measured manner.

Figure 6: Intra-Regional Trade Flows in the Black Sea Region 1999 - 2007

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

BSTDB in the Black Sea Region

{ Overview of Operational Priorities and Products



Overview of Operational Priorities and Products

Having reached the midway point of the implementation of the BSTDB Medium-term Strategy and Business Plan (MTSBP) 2007–2010, management has undertaken a Mid-term Review in order to assess progress to date, and to consider strategic directions to be followed over the last two years of the MTBSP in light of institutional achievements and global developments.

High demand, larger than anticipated operation size and benign market conditions resulted in rapid portfolio growth during 2007–2008 such that the Bank fulfilled its overall operational objectives for the MTBSP period within the first two years of implementation.

During 2008, BSTDB took advantage of a still benign market environment, and higher than anticipated demand for its products, as regional companies came to know the institution and desired to engage it. Significantly, the Bank increased profitability while maintaining conservative provisioning procedures, portfolio quality remained excellent, and progress was achieved in meeting certain developmental objectives such as concentrating on smaller and poorer countries, and identifying more infrastructure operations. Were it not for the significant deterioration in global financial conditions which culminated in the near 'meltdown' of late September/ early October, results for 2008 would certainly have been far larger, with new records set for the Board of Directors (BoD) approvals as well as signings. Twenty of the 21 operations approved during 2008 had been approved by June (for SDR 248.3 million). Similarly, all 30 of the signings that took place during 2008 occurred between January-July. Unfortunately, the global nature of the financial crisis and the prohibitively high costs for BSTDB –particularly given its Baa1 credit rating– to access financial markets resulted in a change of plans in the second half of the year and a near halt to preparation of new operations.

Consequently, the Bank's portfolio of operations expanded rapidly in terms of the BoD approved operations and signed operations ('commitments'). The target amounts projected by the Bank's 2007-2010 MTSBP for BoD approvals were exceeded by the end of 2008. For 2007 and 2008, new BoD approvals reached SDR 688.7 million, a figure 84% higher than the planned SDR 373 million. The story for signings is similar; the level of actual signings for 2007 was more than twice the projected amount for that year, and for 2008 the actual level was nearly twice the targeted level. Overall, new signings amounted to SDR 619.9 million, a figure 98% higher than the planned SDR 308 million.

A similar story may be observed in the evolution of the amounts disbursed and outstanding. The MTBSP projected a doubling in the size of the outstanding portfolio from SDR 300 million in 2006, to SDR 600 million by the end of 2010. By end 2008, the Bank's disbursed and outstanding portfolio of operations stood at SDR 617 million. The four year target was met and slightly exceeded within the first two years.

The Bank's shareholders recently reaffirmed their support by the decision to increase the authorized and subscribed capital of the Bank. The increase of the authorized capital by SDR 2 billion was approved by the Board of Governors (BoG) in December 2007, raising the total authorized capital to SDR 3 billion. The Member States subscribed SDR 1 billion, raising the total subscribed capital to SDR 2 billion. The increase in the capital stock of the Bank was allocated to Member States in October 2008. Further to this development and the overall performance of the Bank, Moody's Investors Service changed the outlook for the BSTDB credit rating of Baa1 from stable to positive in December 2007.

The capital increase represents a powerful statement of commitment to the institution by its shareholders. It is expected to further enhance the Bank's capabilities, competitiveness and performance, including the Bank's ability to attract more funds to the Region, at a moment when mobilization of additional resources is a priority, given the recent rapid growth in the context of constrained global liquidity.

Turning to strategic priorities, the primary operational emphasis of BSTDB in 2009–2010 would be on portfolio growth, maintaining portfolio quality, supervising existing operations, and developing partnerships, while achieving consolidation and improving effectiveness of internal processes. The Action Plan for 2009–2010 gives priority to the following areas:

- Secure Adequate Funding
- Maintain Portfolio Quality and Financial Viability
- Control Expenses
- Information Technology and Management Information System
- Improve Human Resource Management

The Bank will seek to prioritize by focusing more on operations which best meet the dual mandate of promoting economic development and regional cooperation. In practice, this implies a shift towards more public sector or quasi-public sector and related cross-country activities.

Selected BSTDB Financings in 2008

Kürüm International Ltd. Albania

BSTDB extended a EUR 20 million loan to Kürüm International Ltd. Albania, the largest steel producer in Albania. The company is owned by the Kürüm Group (Turkey).

This medium-term facility will be used to finance the Company's investment program which aims to increase capacity, improve quality and cut costs by modernisation and automatation of production facilities in Albania.
In this project, BSTDB co-operated with DEG (Germany) and Raiffeisen Bank (Austria) in financing the Kurum investment expenditures.

In supporting this Turkish investment in Albania BSTDB is able to promote regional cooperation and thus meet one of its key strategic priorities.

Amount: EUR 20,000,000
Type of Financing: Corporate Loan
Maturity: 3 years

Products

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

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

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

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

The Bank has three types of operations:

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

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

Selected BSTDB Financings in 2008

Albtelecom, Albania

BSTDB provided a EUR 25 million long-term loan to finance the development of Albtelecom, the main Albanian telecommunications operator. The loan was extended to a special purpose vehicle owned by a consortium of Turkish investors – Çalık Enerji Telekomünikasyon Hizmetleri A.S and Türk Telekomünikasyon A.S.

The operation represents a total investment of EUR 100 million jointly provided by BSTDB and EBRD, both extending A-loans, and commercial banks extending a B-loan portion of EUR 45 million.

This project will have a high economic development impact as it provides support for the upgrade and development of Albtelecom's network infrastructure, facilitates mobilization of funding from outside the Black Sea region and promotes a co-financing opportunity for commercial banks. The project also advances regional cooperation by involving a Turkish consortium in the privatisation of an Albanian telecoms company.

Amount: EUR 25,000,000
Type of Financing: Corporate Loan
Maturity: 8 years

Co-Financing

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

In 2008 the Bank co-financed 3 operations, Albtelecom, Natfood and Istanbul Kadikoy–Kartal Metro for a total amount of USD 112 million. Since 1999, co-financiers with whom BSTDB has cooperated have included international financial institutions – EBRD, IFC and MIGA, official development institutions of developed countries – JBIC (Japan), KfW Banking Group (Germany), SECO (Switzerland), Netherlands Development Finance Company (FMO), Norfund and Finnfund in Scandinavia, commercial banks – Calyon Bank, BNP Paribas S.A., ING Bank N.V., Cyprus Popular Bank, Citibank, US Ex-Im Bank, HVB Bank Romania SA, Bank Austria Creditanstalt AG, Bayerische Hypo-Und Vereinsbank AG, WestLB AG London, Turkiye Vakiflar Bankasi, Banca OPI S.p.a., Standard Bank, Fortis Bank SA/NV, Landesbank Hessen-Thuringen Girozentrale, Societe Generale S.A., Bayerische Landesbank, Raiffeisen Zentralbank Osterreich Aktiengesellschaft, Turkiye Is Bankasi A.S. - Bahrain Branch, Turkiye Garanti Bankasi A.S., - Luxemburg Branch, Commertzbank AG, Kommunalkredi Austria AG, AKA Ausfuhkredit - Gesellschaft mbH, ABN-AMRO Bank N.V. - London, ABN-AMRO Bank N.V. - Stockholm, Sace SPA - Servici Assicurativi Del Commercio Estero, VTB Bank Europe PLC, Bayerische Landesbank, VTB Bank (France) SA, VTB Bank (Austria) AG, Alpha Bank, Pireaus Bank, Eurobank, Commercial Bank of Greece, Banca Infrastrutture Innovazione E Sviluppo S.p.A, Depfa Bank plc, Denizbank A.S., Succursale in Italia and MCC – Mediocredito Centrale S.p.A. (Unicredit Group), and corporations – Ericsson Credit AB, Nokia Corporation.

Selected BSTDB Financings in 2008

Istanbul Municipality / Kadikoy–Kartal Metro Project, Turkey

This transaction is a club deal bringing together BSTDB and a number of leading international commercial banks to jointly finance the Istanbul Municipality in a metro project for construction of a double track system metro line of 21,020 m. serving seventeen stations along the D–100 highway between Kadikoy and Kartal (on the Anatolian (Asian) side of Istanbul). This new line will provide a connection to the European side of Istanbul through the Bosphorus Tube Tunnel Crossing. The Project is among the highest priorities of the Istanbul Metropolitan Municipality and aims to address some of the traffic congestion problems in Istanbul. Total project costs are EUR 751 million.

Amount: USD 50,000,000
Type of Financing: Project Finance Loan
Maturity: 10 years

SAS Group LLC Operation, Armenia

BSTDB extended a USD 7.6 million corporate loan to SAS Group LLC. The loan will be used to support expansion of the SAS supermarket chain in Yerevan. Partial disbursement of the loan has thus far allowed the Company to complete the refurbishment of two new stores and launch them into operation in 2008.

SAS Group LLC was established in 1998 and is one of the major supermarket chains in the capital of Armenia. At present the Company operates five supermarkets in Yerevan, including the two new stores, all of which are situated in prime city locations.

BSTDB's financing will contribute to the development of the country's consumer goods distribution sector and is expected to have a positive effect on the standards of living in Armenia. The opening of the two new stores financed by BSTDB resulted in creation of 230 new jobs. SAS Group supermarkets offer a wide range of food and consumer goods, a substantial part of which is imported from other BSTDB member states such as Bulgaria, Georgia, Greece, Moldova, Russia and Ukraine. Expansion of the Company's business will support economic cooperation and trade in the Black Sea Region.

Amount: USD 7,600,000
Type of Financing: Corporate Loan
Maturity: 7 years

Special Funds

The Bank administers a Special Fund (the Hellenic Fund) established in July 2001 by a Contribution Agreement between the Government of the Hellenic Republic and BSTDB. The Fund was instituted with an initial amount of EUR 800,000 and was replenished with EUR 500,000 in 2003. The Fund is tied to consulting companies based in Greece. However, up to 25% of an assignment cost may be allocated to consultants who are nationals of the Bank's other member countries. Altogether, the Hellenic Fund has allocated around EUR 958,000 to consulting assignments since inception and out of this amount EUR 887,000 were in fact disbursed. The sectors benefiting from these funds have included manufacturing, telecoms, oil & gas, transportation, agribusiness and banking. These funds were distributed among nine Member States – Albania, Armenia, Bulgaria, Georgia, Greece, Moldova, Romania, Russia, and Ukraine.

The Bank also administers a Technical Cooperation Special Fund (the Fund) newly established with the Development Bank of Austria (OeEB) in October 2008, which became operational in 2009. The OeEB contributed to the Fund an initial amount of EUR 500,000 provided by the Government of Austria as Official Development Assistance (ODA). The Fund is an untied facility offering financing for a wide range of technical assistance services and training needs of BSTDB clients in the countries of the Black Sea region. The Fund represents the first financial facility of this kind provided to BSTDB by a non-regional institution.

Selected BSTDB Financings in 2008

BSTDB Loan to Credit Bank of Moscow for SME Financing, Russia

BSTDB provided a USD 20 million loan to Credit Bank of Moscow for the purposes of financing small and medium-sized enterprises (SMEs) in Russia.
This bank-to-bank loan, with a repayment period of 6 years, addresses the rapidly growing funding needs of Russian SMEs, and contributes to the implementation of the Russian Government's priority policy of promoting the development of the SME sector.

Credit Bank of Moscow is a dynamic mid-sized universal privately owned commercial bank set up in 1992 with an increasing focus on SME and retail business. The bank was ranked 54th by total assets among Russian banks in 2007.

Through this operation, the Bank promotes improved access for SMEs to medium-term funding and supports the development of a successful mid-sized private bank.

Amount: USD 20,000,000
Type of Financing: Bank-to-Bank Loan
Maturity: 6 years

Natfood CJSC, Armenia

In 2008 BSTDB signed a loan agreement with NatFood CJSC, a special purpose company established to implement a project involving construction and operation of a modern meat processing plant in Yerevan, Armenia. The shareholders of NatFood are Mr. Henrik Zakhariants and the European Bank for Reconstruction and Development.

The project represents one of the largest investments to date in the Armenian food processing industry. Total project costs are estimated at USD 18 million. BSTDB is a major provider of debt financing to the project.

BSTDB's facility will support the creation of new jobs and will result in the transfer of modern skills and technology to Armenia. The Company intends to sell the products of the plant both domestically and to Georgia and Russia.

Amount: USD 7,000,000
Type of Financing: Project Finance Loan
Maturity: 7 years

Environment Protection

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

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

In undertaking its environmental mandate the Bank is guided by its Environmental Policy and Environmental Assessment Procedures document. Assessment of the environmental acceptability of proposed transactions together with the environmental performance of the potential Clients is carried out in line with these procedures, as well as relevant best practices applied by other IFIs. All operations that pass the Banks Concept Clearance stage are subject to Environmental Assessment. In the case of environmentally complex operations, which require an Environmental Impact Assessment for instance, or an Environmental Audit, the Bank commissions relevant studies. These studies focus on both the environmental acceptability of the project and the environmental performance of the potential borrower. Public consultations are also considered if the operation is a source of contention locally.

Selected BSTDB Financings in 2008

BSTDB Loan to Evrofinance Mosnarbank for Mortgage Financing, Russia

BSTDB provided to Evrofinance Mosnarbank a USD 38 million Bank-to-Bank loan with a tenor of 7 years, for the purpose of supporting the bank's capacity to better serve the rapidly growing mortgage financing needs of its clients.

Evrofinance Mosnarbank ranks among the top 50 Russian banks in terms of assets and capital. In 2008 Evrofinance Mosnarbank was on the list of the top 1,000 world banks published by The Banker magazine. The regional strategy of Evrofinance Mosnarbank is to cover all cities in Russia, with population over one million people, by the year 2010.

Through this operation, the Bank demonstrates its support for the Russian banking sector by the provision of long term funding to financial institutions to enable them develop mortgage financing and retail banking. This loan will facilitate expansion of the mortgage lending program at a leading Russian bank and as a result will increase the accessibility of funding for the local population.

Amount: USD 38,000,000
Type of Financing: Bank-to-Bank Loan
Maturity: 7 years

BSTDB Trade Finance Program for the Region

Bank Standard, Azerbaijan
Facility Amount: USD 8,000,000
Type of Facility: Revolving Trade Finance Facility
Maturity: Revolving, with maximum disbursement term of 360 days

Cartu Bank, Georgia
Facility Amount: USD 5,000,000 (increased from USD 1,500,000)
Type of Facility: Revolving Trade Finance Facility
Maturity: Revolving, with maximum disbursement term of 360 days

Inecobank, Armenia
Facility Amount: USD 6,000,000 (increased from USD 3,000,000)
Type of Facility: Revolving Trade Finance Facility
Maturity: Revolving, with maximum disbursement term of 360 days

Portfolio Description

Portfolio Structure at end–2008

Since the beginning of operations in June 1999 the Bank has approved 186 operations totaling over SDR 1.56 billion, distributed as follows: 6 in Albania, 10 in Armenia, 17 in Azerbaijan, 20 in Bulgaria, 14 in Georgia, 9 in Greece, 10 in Moldova, 19 in Romania, 39 in Russia, 18 in Turkey and 24 in Ukraine.

At the end of 2008 there were 100 Board approved operations in the active portfolio for a total initially authorized amount of SDR 973.5 million. Of these, 96 operations have been signed for a total amount SDR 853.9 million. In the Bank's active portfolio there are 95 operations for a total outstanding amount of SDR 617 million.

Selected BSTDB Financings in 2008

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

Procredit Bank, Ukraine
Facility Amount: USD 10,000,000
Type of Facility: SME Finance Facility
Maturity: 3 years

ACBA Bank, Armenia
Facility Amount: USD 10,000,000
Type of Facility: SME Finance Facility
Maturity: 5 years

Armeconombank, Armenia
Facility Amount: USD 5,000,000
Type of Facility: SME Finance Facility
Maturity: 5 years

Unibank, Azerbaijan
Facility Amount: USD 5,000,000
Type of Facility: SME Finance Facility
Maturity: 5 years

Bulgarian American Credit Bank, Bulgaria
Facility Amount: EUR 12,500,000
Type of Facility: SME Finance Facility
Maturity: Revolving, with maximum disbursement term of 360 days

Mobiasbanca, Moldova
Facility Amount: USD 5,000,000
Type of Facility: SME Finance Facility
Maturity: 5 years

BM Leasing, Bulgaria
Facility Amount: EUR 5,000,000
Type of Facility: SME Leasing Facility
Maturity: 5 years

Procredit Bank, Georgia
Facility Amount: USD 10,000,000
Type of Facility: SME Finance Facility
Maturity: 3 years

Access Bank, Azerbaijan
Facility Amount: USD 4,000,000
Type of Facility: SME Finance Facility
Maturity: 4 years

NBD Bank, Russia
Facility Amount: USD 5,000,000
Type of Facility: SME Finance Facility
Maturity: 4 years

The structure of the Bank's active portfolio by country and by sector is as follows:

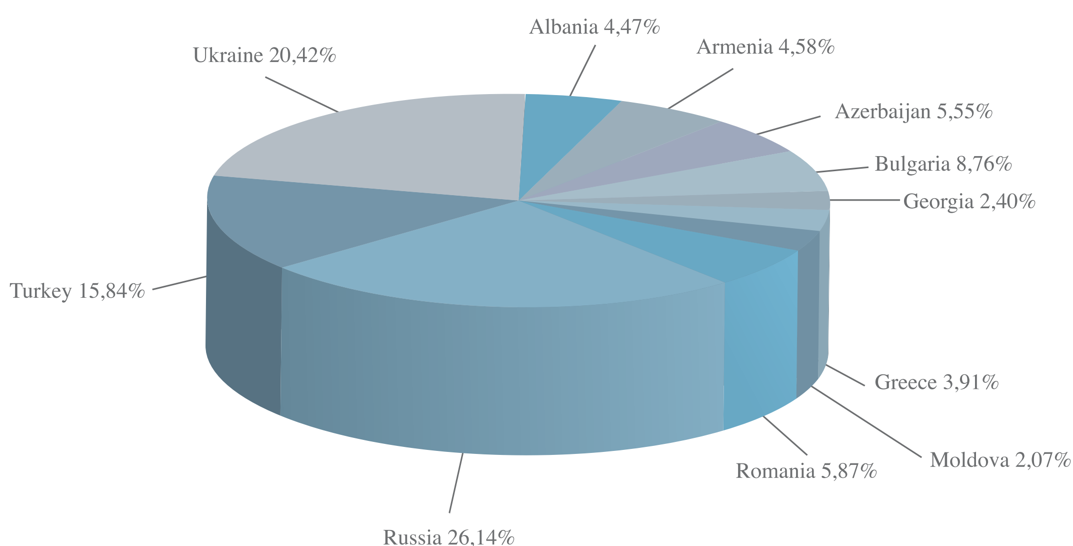
Active Portfolio Structure by Country

Board Approved Operations

There are currently 100 Board of Directors approved operations for a total amount of SDR 973.5 million.

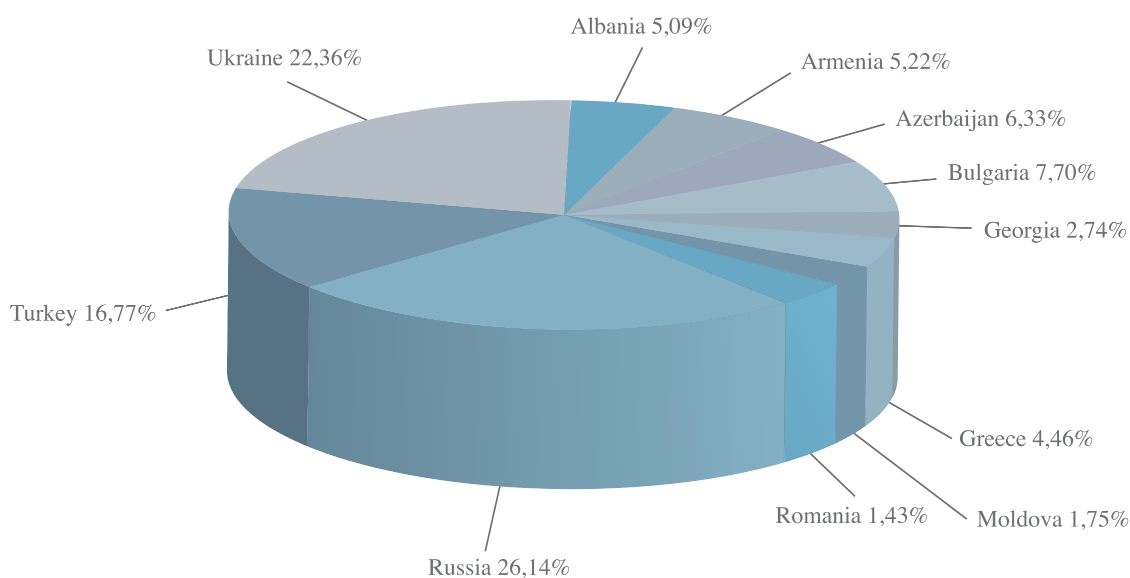
Out of the total number of operations 4 are in Albania, 9 in Armenia, 13 in Azerbaijan, 8 in Bulgaria, 7 in Georgia, 2 in Greece, 6 in Moldova, 5 in Romania, 22 in Russia, 7 in Turkey and 17 in Ukraine.

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



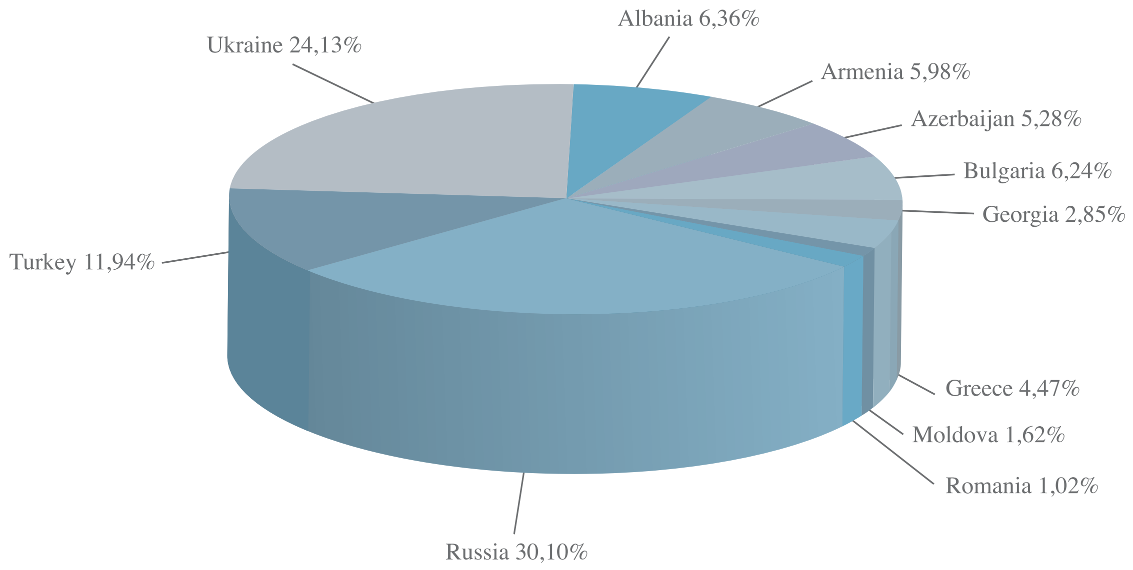
Signed Operations

Of the Board approved total 96 operations are signed for a total amount of SDR 853.9 million. Their distribution by country is as follows:



Outstanding Operations

As of end–2008 the outstanding operations of the Bank (cumulative disbursements less repayments for active operations) represented SDR 617 million, distributed by country as depicted in the following graph:



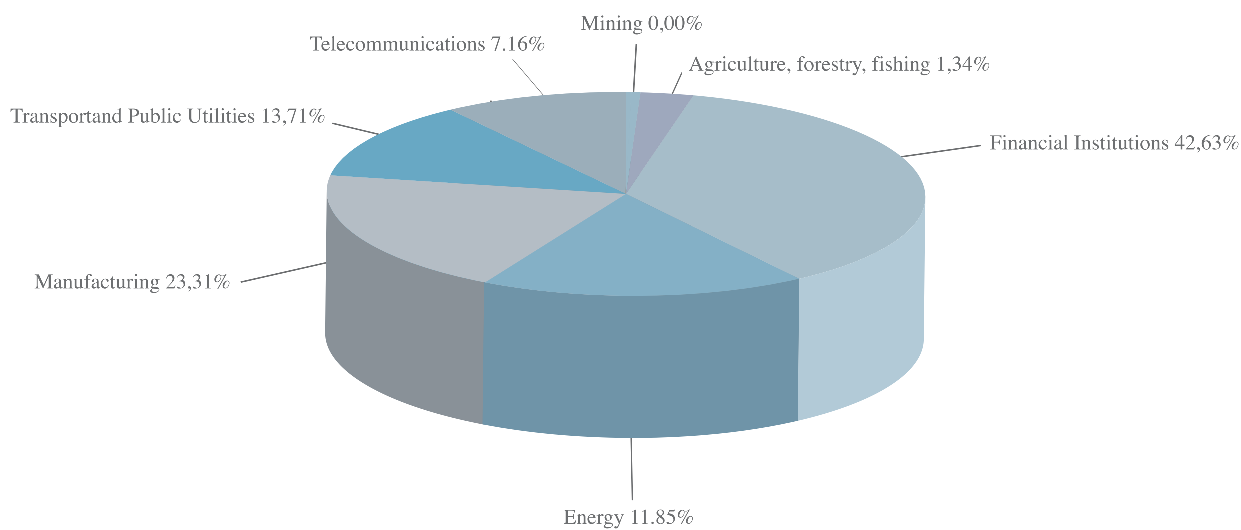
Active Portfolio Structure by Sector

Board Approved Operations

By sector, as at end–2008 the Board of Directors had approved, SDR 11.4 million in 2 operations in agriculture, forestry and fishing, SDR 372.4 million in 51 operations through financial institutions, SDR 154.6 million in 10 operations in energy, SDR 206.3 million in 19 operations in manufacturing, SDR 142.4 in 6 operations in transport and public utilities, SDR 61.8 million in 5 operations in telecommunications and SDR 24.6 million in 1 operation in mining.

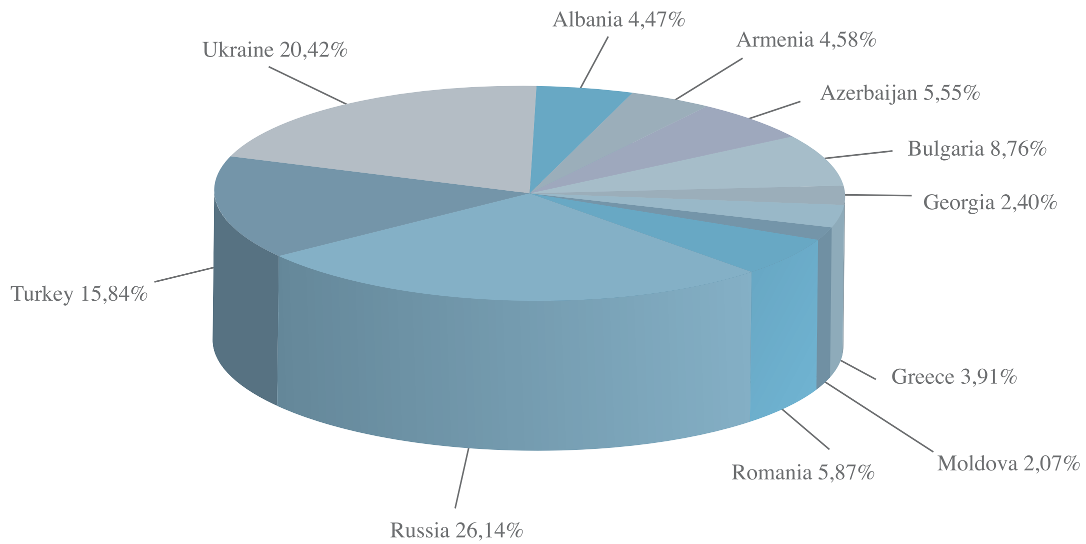
Signed Operations

The distribution of operations by sector is shown in the following graph:

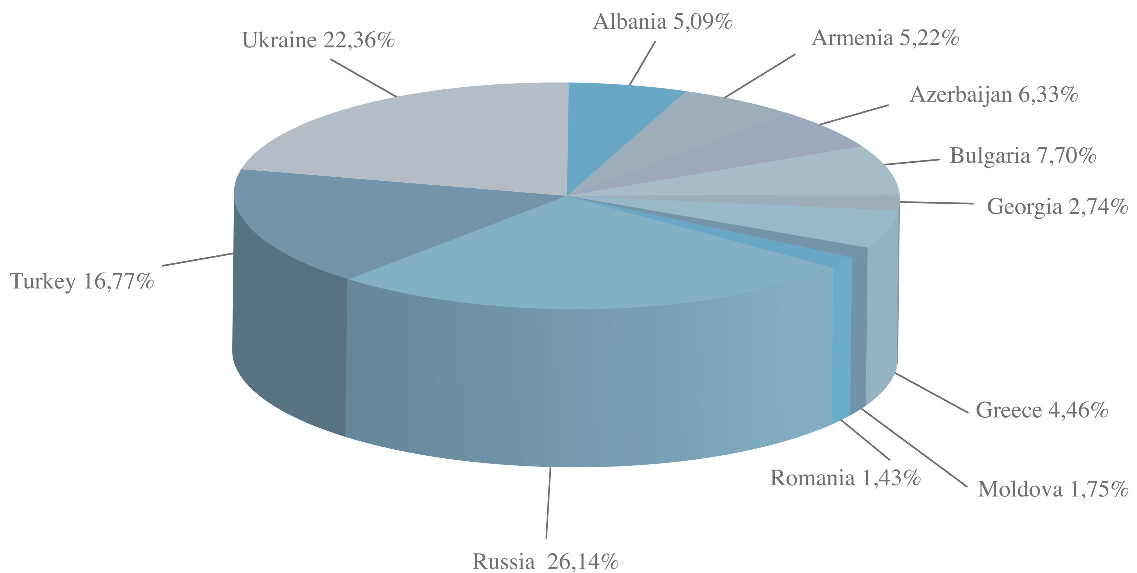


Developments During 2008

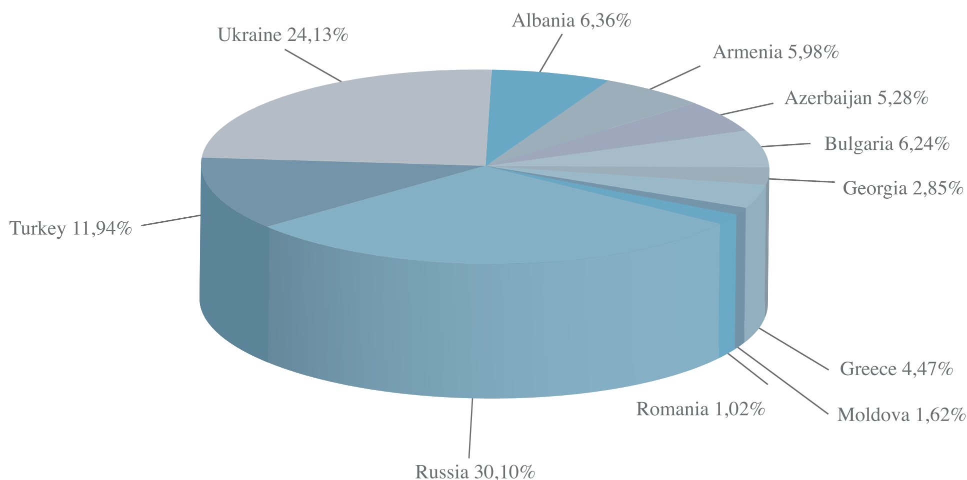
Board Approved Operations by Country



Signed Operations by Country

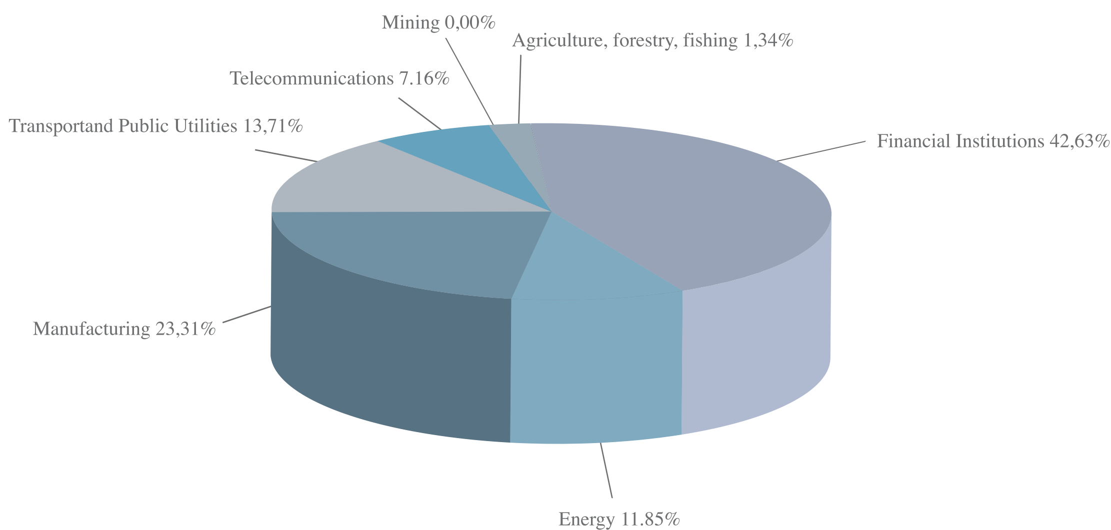


Outstanding Operations by Country

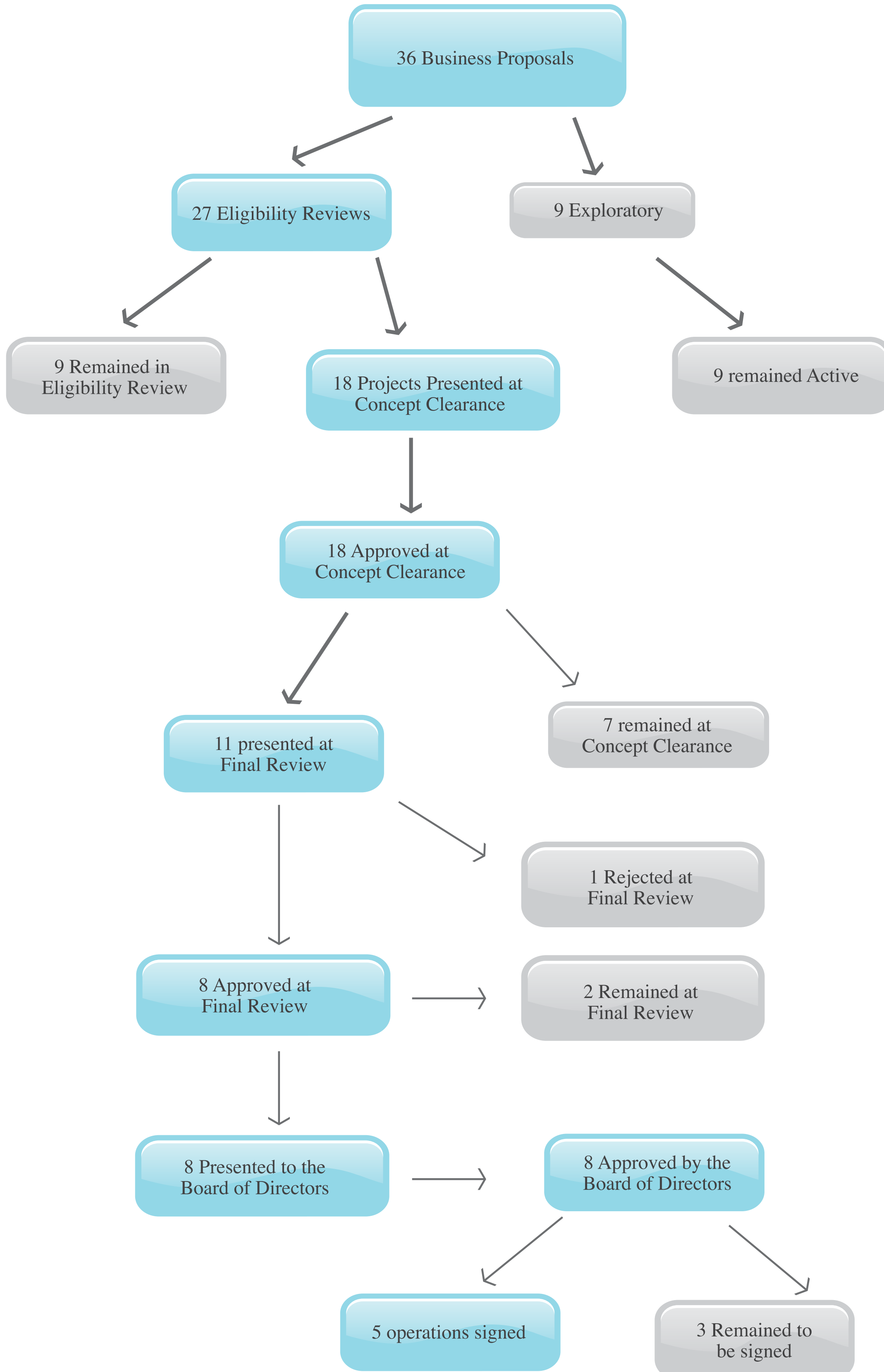


Developments of Outstanding Operations 2007-2008

Signed Operations by Sector



Project Pipeline Statistics for 2008



Use of Resources

Resources Management
Financial Management
Corporate Governance

Resources Management

Human Resources

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

HR Development

In 2008 the BSTDB initiated a HR-Reform. Critical elements of the HR-Reform were and are the HR strategy and the revision of key human resources policies and systems. The HR-Reform's objectives are to obtain a better understanding of Human Resources Management and Development, to increase the clarity, fairness and transparency of HR systems and to bring the policies and processes in line with modern, efficient and international HR practices and standards, accentuating the investment in and development of Human Capital.

Staffing and Recruitment

The BSTDB conducts recruitment on a wide geographical basis, with preference being given to the citizens of Member States. In 2008 staff were recruited in all staff categories. At the end of 2008, the BSTDB had a total of 98 employees, from 14 member and non-member countries.

Staff Development

The BSTDB offers learning opportunities addressing the development needs of its staff and the organization's business requirements. In 2008, the majority of these opportunities focused on technical/professional skills development. Emphasis was placed on further development of the Leadership and Management skills of staff holding managerial posts. Emphasis was also given to the development of a Training Curriculum reflecting the business and the staff members' needs and aligned with the BSTDB Business Plan. Efforts and resources were especially concentrated on the development of new processes and the streamlining of existing ones.

Staff Benefit System

The BSTDB operates a market-oriented staff compensation and benefits policy designed to match the employment standards of other International Financial Institutions. The BSTDB's health and life insurance plan provides medical coverage emphasizing preventive health care.

In 2008, BSTDB negotiated a new Long-Term Disability/Temporary Incapacity Policy for its staff, adding important new benefits and upgrading the existing ones.

The BSTDB Pension Plan, implemented in January 2003, is comprised of a fully funded defined benefit scheme and a matched contribution plan. This combination offers the flexibility crucial to best meet the needs of a multinational work force. In 2008, the BSTDB negotiated with the Trustee the modification of the Pension Plan rules, eliminating some discrepancies and generally upgrading the level of benefits available to departing staff members.

Administrative Services

In 2008, the Administrative Services Department incorporated the recent reorganization effects in its operation and proceeded with a redistribution of tasks in order to achieve the necessary synergies. In addition to this major undertaking, the Administrative Services Department has given emphasis to the preparation of the comprehensive preliminary site allocation program that was used in the call for tenders relating to the Bank's new premises.

Information Technologies

To better align the Bank's IT services with the organisation's strategy the following business initiatives have been performed by the IT Department in year 2008:

• Upgraded the Internet bandwidth of the organization using advance multiplexing techniques and different ISPs in order to increase the Internet access speed and Internet availability.
• Successfully tested the Business Continue Plan (BCP) twice within the year to ensure staff are familiar with the procedures and that the organisation's businesses can be carried out from an alternative location in case of an unexpected disruption.
• Put in place a virtualization server infrastructure using blade servers and the VMware virtualization software in order to consolidate its IT infrastructure, increase IT system availability and reliability, and contribute toward energy savings in line with the green IT concept.
• Implemented a web based IT Help Desk application to better manage IT services and users' requests related to incidents, problems and change management.

External Relations

In 2008 the Bank accelerated its institutional relations with international organizations with the objective of facilitating business generation in the Black Sea Region. Enhanced cooperation with the Organization of the Black Sea Economic Cooperation (BSEC) and its family institutions remained an important priority. The Bank intensified its collaboration with relevant BSEC bodies dealing with the preparation of the Black Sea Ring Highway and Motorways of the Sea projects initiated by BSEC.

BSTDB cooperation with the European Commission and EU institutions was maintained on regular basis.

A major breakthrough in 2008 was achieved in the Bank's institutional relations with other IFIs and non-regional donor institutions. During the year, four BSTDB partner financial institutions applied for and were granted Observer Status with the Bank, including the European Investment Bank (EIB), Nordic Investment Bank (NIB), the Development Bank of Austria (OeEB) and the Association of the European Development Finance Institutions (EDFI). The Observer Status of the KfW Banking Group (Germany) was renewed for an unlimited period.

As a result of the above institutional rapprochement, the Development Bank of Austria and BSTDB have established a Technical Cooperation Special Fund fully financed by the Government of Austria as Official Development Assistance (ODA). This untied facility administered by BSTDB provides opportunities to finance a broad variety of technical assistance services related to project preparation and professional training for BSTDB clients in the financial sector of the Bank's member countries. The Fund represents the first facility of its kind provided to BSTDB by a non-regional donor.

Working contacts have been improved at different levels with other IFIs and donors active in the Region.

In 2008 the Bank became a member of the Institute of International Finance (Washington) a global association of financial institutions with the intention of active participation in international economic and financial policy discussions, accessing quality market analysis, and promoting institutional collaboration with the world's leading investors.

In its drive to generate business and facilitate investments in its member countries, BSTDB took an active part in a number of international business events, delegating speakers to 18 conferences and events to promote its activities in the Region. BSTDB sponsored several regional business events, including the 4th Emerging Europe Energy Summit and the BSEC Energy Forum. In October 2008, BSTDB became an institutional partner with Euromoney in organizing the 8th South East Europe Finance and Investment Conference in Thessaloniki.

BSTDB contributed statements and interviews to leading international editions distributed in the World Bank, EBRD, ADB Annual Meetings and Business Forums and national publications in the member countries promoting the Region as an attractive investment destination.

The Bank hosted its Annual Meeting in Saint-Petersburg, Russia in conjunction with the high-profile St. Petersburg International Economic Forum.

Planning and Budgeting

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

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

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

The Bank also has established Management Information Systems to support its internal structure by providing detailed financial and management information. This is utilised for decision-making, performance reporting, monitoring and internal control purposes.

Financial Management

Business Volume

In this year of operation, the Bank's total assets reached SDR 815 million, representing nearly a 45% expansion from the previous year. The Bank increased the size of its outstanding loan and equity portfolios to SDR 616,511 thousand. Funds committed but not yet disbursed stood at SDR 122,432 thousand at the end of the year.

Revenues

Total income from lending activities rose to SDR 38,555 thousand during the year from SDR 30,360 thousand in 2007; an increase of nearly 27%. Treasury activities in 2008 generated total interest income of SDR 6,960 thousand from its available for sale and held to maturity portfolios. Operating income for the year was SDR 28,985 thousand compared to SDR 26,049 thousand in 2007, an increase of almost 12%.

Expenses

Interest expense for the year was SDR 16,362 thousand and has significantly increased from the previous year, due to the increased borrowing requirements driven by the growth in the Bank's operations portfolio.

Administrative expenses, including depreciation, in 2008 were SDR 11,557 thousand, a marginal increase of SDR 311 thousand over the previous year. Administrative expenses include salaries, benefits and other administrative costs.

Salaries and benefits, in the amount of SDR 8,663 thousand showed a decrease of SDR 213 thousand from the previous year. This included a supplementary amount of SDR 72 thousand recognised in the actuarial valuation of the Bank's staff retirement plan. Other administrative costs had an increase from the previous year to the amount of SDR 537 thousand.

Overall, administrative expenses were well within the 2008 Budget, reflecting the Bank's effective cost controls.

Net Income

Income before impairment during the year was SDR 17,428 thousand, higher than 2007 by an amount of SDR 2,625 thousand. This increase was primarily driven by the improvement in revenues. Impairment losses in an amount of SDR 4,388 thousand were due to an increase in general provisions consistent with the higher business volumes.

The Bank posted a net income for the year of SDR 13,040 thousand, while the quality of the asset portfolios remain sound and the Bank suffered no additional impairment to its operations.

Capital Base

Existing Share Capital

The initial authorised share capital of the Bank was SDR 1 billion divided into one million shares having a par value of SDR 1,000 each. Member States have currently subscribed to all of the initial authorised share capital. Each of Armenia, Georgia and Moldova voluntarily agreed to reduce its share from 2 percent to 1 percent in June 2004 leaving SDR 30,000,000 unsubscribed. At the Board of Governors meeting on October 5th 2008 it was decided that Azerbaijan would take up this 3 percent of unsubscribed shares. As of 31 December 2008, Azerbaijan had paid SDR 1.685 million towards their take up of unsubscribed shares. The balance of SDR 7.315 million is due to be paid by Azerbaijan in 2009.

The subscribed capital has been paid according to the following pre-agreed schedule:
• payment of the paid-in portion of the subscribed capital equivalent to 10 percent of the subscribed number of shares (totalling SDR 100 million) was paid in cash by the Member States within 60 days of the date on which they became Member States;
• in 1998, payment of the paid-in portion of the subscribed capital equivalent to 20 percent of the subscribed number of shares (totalling SDR 200 million) was secured by promissory notes or other obligations issued by each Member State, and actual payment for these shares was made by each Member State in eight equal successive annual instalments between 1998 and 2005; and
• payment for the remaining callable portion of the subscribed capital, equivalent to 70 percent of the shares (totalling SDR 700 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.

New Subscribed Share Capital

The Board of Governors decided in December 2007 to approve an increase to the Bank's authorised capital from SDR 1 billion to SDR 3 billion. They further approved an SDR 1 billion increase in the subscribed capital to be subscribed by the existing Member States, thereby increasing subscribed capital to SDR 2 billion. An announcement that this additional SDR 1 billion was fully subscribed was made after the Board of Governors meeting on October 5th 2008. Georgia declined to take up its 1 percent allocation and this was taken up by Romania. Upon completion of the subscription: Greece, Russia and Turkey remain the largest shareholders of the Bank with 16.5 percent stakes each, followed by Romania with 14 percent, Bulgaria and Ukraine with 13,5 percent each, Azerbaijan with 5 percent, Albania with 2 percent, Armenia and Moldova with 1 percent each, and Georgia with 0,5 percent stake.

The new subscribed capital will be paid according to the following schedule:
• payment of the paid-in portion of the new subscribed capital, equivalent to 10 percent subscribed number of shares (totalling SDR 100 million) will be paid in cash by the Member States in 2010;
• payment of the paid-in portion of the new subscribed capital, equivalent to 20 percent of the subscribed number of shares (totalling SDR 200 million) will be made by each Member State in eight equal successive annual instalments between 2011 and 2018; and
• payment for the remaining callable portion of the new subscribed capital, equivalent to 70 percent of the subscribed number of shares (totalling SDR 700

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.

The Board of Governors may also authorise additional subscriptions from the remaining SDR 1 billion of authorised 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 member of the Bank (currently Serbia) wishes to subscribe for BSTDB shares; or
• 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 of the BSTDB.

Gearing Ratio

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

The Bank's institutional gearing ratio, the statutory limit on the total amount of ordinary operations (outstanding loans, equity investments and guarantees) is 150% of the Bank's unimpaired subscribed capital, reserves and surpluses, which at the end of 2008 stood at slightly above SDR 1.5 billion.

The operational gearing ratio was set at 100% of the Bank's unimpaired paid-up capital, reserves and surpluses and the usable portion of callable capital, that limit the total amount of operations at approximately SDR 1.050 billion.

Provisioning

The IFRS–compliant provisioning policy is designed to ensure that the level of general provisions is commensurate with overall portfolio risk levels. While each operation contributes to the general provisions, specific provisions are only allocated if and when a specific operation encounters difficulties. Total provisions at end of 2008 stood at SDR 30,838 thousand, equivalent to 5.1% of the outstanding loan portfolio.

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

Reserves and Surplus

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

In addition to building up a cushion of reserves, the Bank also set aside retained income to enable it to maintain the real value of its capital funds and increase its 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. More specific subsidiary documents detailing credit risk parameters, liquidity restrictions, interest rate and foreign exchange risk are approved on an ongoing basis by the appropriate executive committees.

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

Operational Risks

The Bank, like all financial institutions, is exposed to operational risks, which are risks other than those falling within the scope of credit and market risk. The Bank relies upon internal controls within its offices and departments for its operational risk management. The Bank also adopts market best practices and methods to manage and coordinate its operational risks.

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

Furthermore, the Bank utilises the Basic Indicator Approach (BIA) as issued by the Basel Committee to quantify operational risk incurred. Banks using the BIA must hold capital for operational risk equal to the average over the previous three years of a fixed percentage of positive annual gross income. Figures for any year in which annual gross income is negative or zero should be excluded from both the numerator and denominator when calculating the average. Should the Bank quantify the operational risk incurred in its operations it would, with the use of the BIA, amount to less than SDR 5.3 million for 2008 and less than SDR 4.1 million for 2007, being a fraction of the Bank's total reserves amount.

Investment / Liquidity

The Bank's surplus funds totalling SDR 206,371 thousand as at 31 December 2008 were invested in two types of money market instruments:
• Short-term deposits with institutions

long term rated at a minimum of A2/A by either Moody's or Standard & Poors credit rating agency.
• Euro commercial paper rated at a minimum short term A1/P1 by either Moody's or Standard & Poors credit rating agency.

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

The Bank's liquidity ratio calculated as liquid assets over 12 months net cash requirements including signed undisbursed commitments, stood at 310% on 31 December 2008.

Borrowing

At end–2008, the Bank had signed loan agreements for EUR 135 million and USD 525 million. As the size of the Bank's operational portfolios continue to increase, and taking into consideration its minimum liquidity requirements, the Bank will access additional sources of long term funds in 2009.

The Bank has a long term investment grade credit rating from Moody's Investors Service of Baa1 (with a positive outlook), and a short term rating P2.

Risk Analysis

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

Risk Mitigation

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

Evaluation

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

Preferred Creditor Status

As an international financial institution, the Bank has preferred creditor status. This means that the Bank usually will:
• Not reschedule debt payments or participate in debt rescheduling agreements with respect to its loans to, or guaranteed by, its Member Countries of operations.
• Not reschedule its loans to private sector borrower where the borrower's inability or anticipated inability to service its debt is due to a general foreign exchange shortage in the borrower's country.

Corporate Governance

Management Structure

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

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

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

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

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

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

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

Compliance

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

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

Reporting and Disclosure

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

With respect to external financial reporting, the Bank presents financial statements in its quarterly Summary Statements and in the Annual Report. Pursuant to Article 35 of the Establishing Agreement, these reports are transmitted to the Governments of the Member States (Annual Report only), members of the Board of Governors and Directors and the BSEC Permanent International Secretary. The Annual Report for 2008 is the tenth report published following the commencement of operations of the Bank.

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

Internal Audit

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

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

External Auditors

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

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

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 responses on the effectiveness and efficiency of internal controls and other matters.

Internal Controls Over Financial Reporting

A longstanding requirement of organisations is to maintain systems of internal control. The requirement for management to certify and an independent auditor to attest to the effectiveness of those systems, has become even more compelling in recent years.

An organization needs internal controls to provide greater assurance that they will achieve their operating, financial reporting, and compliance objectives.

Internal Control, according to the definition established by COSO, is a process, effected by an entity's board of directors, management and other personnel, designed to provide assurance regarding the achievement of objectives in the effectiveness and efficiency of operations, reliability of financial reporting, compliance with applicable laws and regulations.

A robust system of internal controls ensures that the policies, procedures, and practices designed and approved by management and the Board of Directors are functioning properly and as designed.

Recognising the need for effective internal controls, in 2008, the Bank formalized its existing mechanism and established a functioning, consolidated and on-going mechanism to be able to certify in the Annual Report as to the effectiveness of internal controls over external financial reporting, using the COSO's Internal Control Framework and Enterprise Risk Management, as a basis.

The Internal Controls over Financial Reporting (ICoFR) exercise was the first acid test for the quality and effectiveness of the Bank's system of internal controls. The exercise was broken down and executed in 5 phases, as indicated in Figure 1.

Figure 1: Internal Controls over Financial Reporting – Phases

The definition of internal control (Phase 1), applicable to the Bank's environment and objectives was established, after thorough analysis of the Bank's internal environment and research on international standards, COSO Internal Control – Integrated Framework, COSO Enterprise Risk Management – Integrated Framework and IT Governance Institute's Control Objectives for Information and related Technology (CoBIT). In defining the internal controls emphasis was given to the five control components of the COSO integrated framework: Control Environment, Risk Assessment, Control Activities, Information & Communication, and Monitoring.

A Working Group was established with representatives from all the Bank's Divisions (Phase 2), to assist in the documentation of internal processes and the evaluation of the internal controls mechanism. Each process was documented in 3 ways: in a Narrative, a Flowchart and a Risk Assessment Matrix.

- A Narrative describing in detail the process (scope, objectives, inputs, outputs, systems, steps)
- A Flowchart describing the flow of transactions
- A Risk Assessment Matrix including identification of the risks and description of the key controls and related assertions and COSO components

Additionally, a Bank-wide training was conducted by the Internal Audit Department and the External Auditors to enhance awareness in the Bank's internal environment.

The evaluation phase commenced by considering internal controls at the organization or corporate governance level. Internal controls at the entity level were identified, documented and evaluated (Phase 3).

According to COSO ERM, risk assessment allows an entity to consider the extent to which potential events have an impact on achievement of objectives.

Factors that were considered during the overall risk assessment were the following:

- The size and complexity of the organization
- The nature of the organization's operations
- The purpose for which monitoring is being conducted, and
- The relative importance of the underlying controls in meeting the organization's objectives

Internal processes assessed to be significant as a result of materiality analysis of the Bank's financial statements and having taken into consideration the risk assessment criteria of COSO, were evaluated at a process, transaction and application level (Phase 4).

The major processes that were in scope of the Internal Controls over Financial Reporting exercise for 2008 were the following (see also figure 2):

- Banking Operations
- Project Finance
- Operations Following Expedited Procedures
- Equity Investments
- Financial Management & Accounting
- Treasury Operations
- Information Technology
- Human Resources

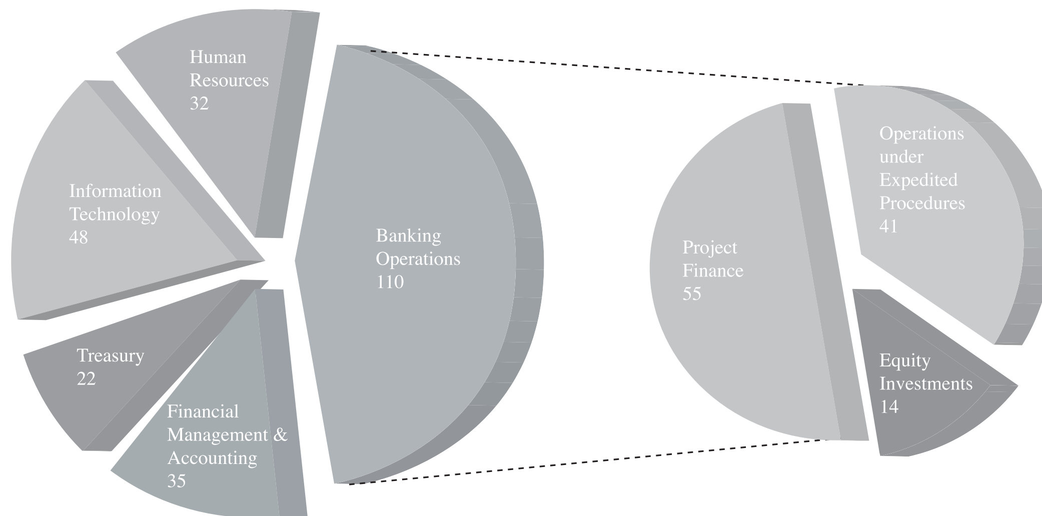


Figure 2: Processes in scope for ICoFR 2008

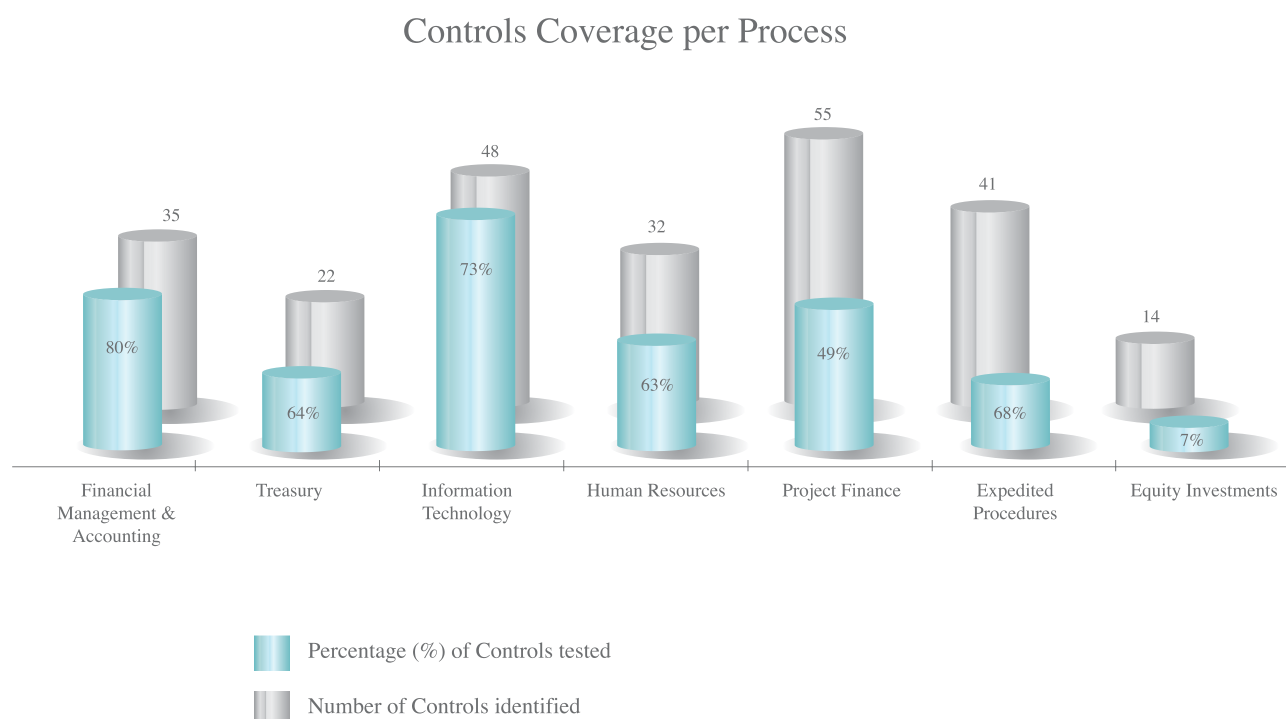


Figure 3: Controls Coverage per Process

Each process was analyzed in several sub-processes and controls were identified to facilitate the evaluation of the design and operating effectiveness of each business cycle. All controls identified were verified to evaluate design effectiveness and all key controls were tested to evaluate operating effectiveness. In Figure 3, the total number of controls in each process and the respective percentage of key controls that was tested are indicated.

Finally, an overall assessment of the effectiveness and efficiency of internal controls was performed. The assessment of the effectiveness of internal control relates to whether the COSO components, acting together, and implemented according to management's judgment, achieve the objectives of internal control over financial reporting. Assessing the effectiveness of design and operating effectiveness of internal control requires judgment.

Based on the assessment performed by the Bank, the internal controls over financial reporting were assessed as effective. For the weaknesses identified which were not classified as material weaknesses, a remediation plan was produced and a monitoring system was established.

Upon the overall assessment of the effectiveness of internal controls over financial reporting, an annual certification statement was 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. This opinion is given as a separate report to the audit opinion on the Financial Statements.

Financial Statements and Notes

Financial Statements for the Year Ended 31 December 2008

Income Statement

For the year ended 31 December 2008

Expressed in thousands of SDR	Note	2008	2007
Interest and similar income	2	42,377	31,450
Interest and similar expense	3	(16,362)	(7,495)
Net interest income		**26,015**	**23,955**
Fees and commission income	4	3,138	2,506
Fees and commission expense	5	(492)	(478)
Dividend income	10	46	0
Net gains from available-for-sale equity investments	10	475	0
Net gains from available-for-sale treasury assets		24	1
Net income (loss) on foreign exchange		(268)	102
Other income (expense)		47	(37)
Operating income		**28,985**	**26,049**
Administrative expenses	6,24	11,249	10,972
Depreciation and amortisation	13,14	308	274
Income before impairment		**17,428**	**14,803**
Impairment losses on loans	7	4,388	5,706
Net income for the year		**13,040**	**9,097**
Earnings per share	17	0.044	0.031

The accompanying notes are an integral part of this statement.

Balance Sheet

At 31 December 2008

Expressed in thousands of SDR	Note	2008	2007
Assets			
Cash and bank balances	20	5,223	5,320
Placements with financial institutions	20	454	0
Investment securities:			
Available-for-sale	20	34,837	44,562
Held-to-maturity	20	165,857	55,886
Total deposits and securities		206,371	105,768
Derivative financial instruments	8	961	238
Loans	9,11	606,746	465,632
Less: impairment losses on loans	7	(30,838)	(25,846)
Loans net of impairment		575,908	439,786
Equity investments:			
Available-for-sale	10,11,20	9,765	7,890
Other assets	12	21,340	10,381
Property and equipment	13	297	308
Intangible assets	14	402	449
Total Assets		**815,044**	**564,820**
Liabilities			
Borrowings	15	459,295	231,795
Payables and accrued interest	16	5,348	2,159
Deferred income	4	4,741	3,200
Total liabilities		469,384	237,154
Members' Equity			
Authorised share capital	17	3,000,000	1,000,000
Less: unallocated share capital	17	(1,000,000)	(30,000)
Subscribed share capital	17	2,000,000	970,000
Less: callable share capital	17	(1,400,000)	(679,000)
Less: payable share capital	17	(300,000)	0
Advance against future call	17	32	35
Paid-in share capital		300,032	291,035
Reserves	18	18,309	18,544
Retained earnings		27,319	18,087
Total members' equity		345,660	327,666
Total Liabilities and Members' Equity		**815,044**	**564,820**
Off-balance-sheet items			
Commitments	11	122,432	76,204

The accompanying notes are an integral part of this statement.

Statement of Changes in Members' Equity

For the year ended 31 December 2008

Expressed in thousands SDR	Share capital					
	Subscribed	Callable	Payable	Reserves	Retained Earnings	Total
At 31 December 2006	**970,000**	**(679,000)**	**37**	**13,493**	**13,610**	**318,140**
Net gain of available-for-sale				431		431
Income recognised directly in equity				431		431
Net income for the year					9,097	9,097
Total income for the year				431	9,097	9,528
Advance against future call			(2)			(2)
General reserve				4,620	(4,620)	0
At 31 December 2007	**970,000**	**(679,000)**	**35**	**18,544**	**18,087**	**327,666**
Reallocated share capital	30,000	(21,000)	0			9,000
Increase in share capital	1,000,000	(700,000)	(300,000)			0
Net (loss) of available-for-sale				(4,043)		(4,043)
Income recognised directly in equity				(4,043)		(4,043)
Net income for the year					13,040	13,040
Total income for the year				(4,043)	13,040	8,997
Advance against future call			(3)			(3)
General reserve				3,808	(3,808)	0
At 31 December 2008	**2,000,000**	**(1,400,000)**	**(299,968)**	**18,309**	**27,319**	**345,660**

The accompanying notes are an integral part of this statement.

Statement of Cash Flows

For the year ended 31 December 2008

Expressed in thousands of SDR	Note	2008	2007
Cash flows from operating activities			
Net income for the year		13,040	9,097
Adjustment for:			
Impairment losses on loans		4,388	5,706
Depreciation and amortisation		308	274
Interest and similar income		(42,377)	(31,450)
Interest and similar expense		16,362	7,495
Foreign exchange adjustments on provisions		604	(877)
Operating income before changes in operating assets		(7,675)	(9,755)
Derivative movements		(723)	(264)
Increase in other assets		(2,595)	(519)
Decrease in accounts payable		269	(379)
Increase in deferred income		1,541	905
Interest and similar income received		40,872	27,686
Interest and similar expense paid		(13,442)	(6,711)
Fair value movements		(4,043)	431
Cash generated from operations		14,204	11,394
Proceeds from repayment of loans		245,149	215,115
Proceeds from repayment of equity investments		7,180	3,457
Funds advanced for loans		(386,264)	(385,675)
Funds advanced for equity investments		(9,054)	(6,492)
Net cash used in operating activities		(128,785)	(162,201)
Cash flows from investing activities			
Proceeds from available-for-sale investment securities		15,743	6,759
Purchase of available-for-sale investment securities		(6,018)	(23,831)
Purchase of property, technology and equipment		(250)	(242)
Net cash used in investing activities		9,475	(17,314)
Cash flows from financing activities			
Increase in paid-in share capital		9,000	0
Decrease (increase) in share capital receivable		(6,859)	404
Decrease in advance against future call		(3)	(2)
Paid-in share capital received		2,138	402
Proceeds from borrowings		454,531	314,273
Repayments of borrowings		(227,031)	(155,985)
Net cash provided by financing activities		229,638	158,690
Net increase (decrease) in cash and cash equivalents		**110,328**	**(20,825)**
Cash and cash equivalents at beginning of year		61,206	82,031
Cash and cash equivalents at end of year	19	**171,534**	**61,206**

The accompanying notes are an integral part of this statement.

Accounting Policies

Summaries of the Bank's significant accounting policies applied in the preparation of these financial statements are identified in this section. These policies have been consistently applied to all the financial periods being presented, unless otherwise indicated.

Establishment of the Bank

Agreement Establishing the Bank

The Black Sea Trade and Development Bank (the "Bank"), whose headquarters is located at 1 Komninon Street, Thessaloniki, in the Hellenic Republic, was established as an international financial organisation under the Agreement Establishing the Bank dated 30 June 1994 (the "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 mobilise financial resources and to improve access to financing for businesses in the whole region as well as for those active only in its individual Member Countries. The Bank offers project and trade financing facilities, equity participations and guarantees. Bank financing of projects and programs is available directly or in cooperation with other national and international development institutions. The Bank may also, where appropriate, provide technical assistance to potential clients.

As at 31 December 2008 the Bank's shareholders comprised 11 countries: Albania, Armenia, Azerbaijan, Bulgaria, Georgia, Greece, Moldova, Romania, Russian Federation, Turkey and Ukraine.

Headquarters Agreement

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

Approval of Financial Statements

The financial statements for 2008 were submitted by the Management Committee to the Board of Directors for approval on 10 April 2009, 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 in their Annual Meeting to be held on 14 June 2009.

Basis of Financial Statements

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

The Bank's unit of account is Special Drawing Rights ("SDR") for its authorised share capital, in accordance with Article 4 of the Establishing Agreement. Pursuant to this, the functional and presentation currency of the Bank is the SDR as defined by the International Monetary Fund ("IMF"). The value of the SDR is based on the weighted average of the values of a basket of major international currencies and the SDR interest rate is a weighted average of interest rates on short term instruments in the markets for the currencies in the valuation basket.

Foreign Currencies

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

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

	31 December 2008	31 December 2007
1 SDR = United States dollar	1.54027	1.57848
= Euro	1.10177	1.07350
= Japanese yen	139.30194	178.14720
= Pound sterling	1.05657	0.78932
= Azerbaijan manat	1.23761	-
= Romanian lei	4.44861	3.86380

Recognition and Derecognition

The Bank recognises a financial asset or financial liability in its balance sheet when, and only when, it becomes a party to the contractual rights or obligations.

The Bank derecognises a financial asset or a portion of financial asset when, and only when, it loses control of the contractual rights that comprise the financial asset or a portion of the financial asset. The Bank derecognises a financial liability when, and only 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 purpose of the "statement of cash flows" cash and cash equivalents consist of cash on hand, placements with other financial institutions and debt securities with original maturities of three months or less. These are highly liquid assets that are readily convertible to a known amount of cash and are subject to insignificant risk in value.

Financial Instruments

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

Financial Assets

The Bank classifies financial assets in the following categories: loans and receivables, held-to-maturity investments and available-for-sale financial assets. Their classification is determined at the time of initial recognition.

Held-to-maturity investments and available-for-sale financial assets are recognised on a trade date basis, which is the date the Bank commits to purchase or sell the asset. All loans are recognised when cash is advanced to borrowers at settlement date.

The Bank did not reclassify any non-derivative financial assets out of the fair value through profit or loss category in any particular circumstance. Nor did the Bank transfer any financial assets from the available-for-sale category to the loans and receivables category.

Loans and Receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Third party expenses, such as legal fees, incurred in securing a loan are treated as part of the cost of the transaction. Subsequently, loans are measured at amortised cost using the effective interest rate method less any provision for impairment or uncollectability. All revenues generated are reported in the income statement.

Held-to-Maturity

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

Available-for-Sale

Financial assets such as the Bank's equity investments or held bonds are classified as available-for-sale intended to be held for an indefinite period of time, and may or may not be sold in the future. After initial recognition at cost, these financial assets are measured at fair value. The fair value of the available for sale securities that are traded in organized financial markets is determined by reference to quoted market bid prices. For those where there is no active market, the fair value is determined using accepted valuation techniques.

The unrealized gains and losses that arise from fluctuations in fair value are recognised as a separate component of equity until the financial asset is sold or derecognised for any other reason or until the investment is determined to be impaired, at which time, the cumulative gain or loss previously reported in equity is included in the income statement. Foreign exchange gains or losses and any income accrued, by using the effective interest rate method for these assets, are recognised directly in the income statement. Dividends received are included in the income statement.

Financial Liabilities

Financial liabilities include borrowings and other liabilities.

Borrowings

Borrowing transactions are recognised in the balance sheet at the time the funds are transferred to the Bank. They are initially stated 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 balance sheet at fair value where the amortised cost value is adjusted to fair value by the hedged risks, with any changes in value recognised in the income statement. Relevant interest expenses are reported in the income statement using the effective interest rate method.

Other Liabilities

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

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 recognised in the balance sheet at cost and are carried as assets when fair value is positive and as liabilities when fair value is negative. Changes in fair value of derivatives are included in the income statement. Fair values are obtained from quoted market prices, to the extent publicly available, discounted cash flows and options pricing models as appropriate.

Currently, given the market sensitivity, the Bank is only involved with foreign exchange forwards.

Impairment

An impairment loss for the Bank is the amount by which an asset's recorded carrying amount exceeds its expected recoverable amount.

Financial Assets Carried at Amortised Cost

For amounts due from loan and receivable portfolios, losses under guarantees, commitments, held-to-maturity and other investments carried at amortised cost, the Bank first assesses whether objective evidence of impairment exists individually for those that are individually significant, or collectively for those that are not individually significant. If the Bank determines that no objective evidence of impairment exists for an individually assessed asset, whether significant or not, it includes the asset in a group of assets with similar

credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Delinquency in contractual payments of principal or interest
- Cash flow difficulties experienced by the borrower
- Breach of loan covenants or conditions
- Initiation of bankruptcy proceedings
- Deterioration in the borrower's competitive position, and
- Deterioration in the value of collateral

If there is objective evidence that an impairment loss has been incurred, that the Bank will not be able to collect all amounts due (principal and interest) according to original contractual terms, such assets are considered and classified as "non-performing". The amount of the loss is measured as the difference between the asset's carrying amount and the present value of expected future cash flows (excluding future credit losses that have not yet been incurred). The carrying amount of such an asset is reduced to its estimated recoverable amount through the use of an allowance for impairment account and the amount of loss is recognised in the income statement. Interest income continues to be accrued based on the original effective interest rate of the asset. The Bank ceases to accrue interest on those assets classified as non-performing for more than 90 days, or earlier when there is reasonable doubt as to actual collection, and for which the recoverable amount is determined primarily in reference to fair value of collateral.

An asset together with the associated allowance is written off when all or part of it is deemed uncollectible, liquidation or all legal and other avenues for recover or settlement are exhausted, or in the case of debt forgiveness. Write-offs are charged against previously established allowances and reduce the principal amount of an asset. Whenever an amount of the estimated impairment loss increases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased by adjusting the allowance account. Recoveries of such assets written off in earlier periods are included in the income statement.

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

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

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.

Available-for-Sale Financial Assets

At each balance sheet date the Bank assesses whether there is objective evidence that a financial asset or a group of financial assets is impaired. For equity investments carried at fair value, a significant or prolonged decline in the fair value below its cost is considered in determining whether the assets are impaired. If any such evidence exits, the cumulative impairment loss, which is measured as the difference between the acquisition cost and the current fair value, net of any impairment loss previously recognised in net income, is removed from reserves and included in the income statement. Impairment losses once recognised and included in the income statement on these equity investments carried at cost, are not reversed.

For debt securities the Bank assesses at each balance sheet date whether there is objective evidence of impairment. The criteria that the Bank uses to determine that there is objective evidence of an impairment loss include:

- Downgrading of the issuer below minimum eligibility levels for Treasury exposures
- Issuer failure to pay amounts contracted under the security
- Covenant breaches, default events and trigger level failures

• Deterioration of credit enhancement including diminution of collateral value, and
• Legal proceedings such as bankruptcy, regulatory action or similar

If any such evidence exists, the cumulative impairment loss measured as the difference between the acquisition cost and the current fair value is removed from reserves and included in the income statement. If in a subsequent period the impairment indications of such securities cease to exist, related to an event after the impairment loss was recognised, that loss is reversed through the income statement.

Non Financial Assets

At each balance sheet 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 the income statement.

Renegotiated Loans

When necessary, the Bank seeks to restructure loans that may involve extending the payment arrangements and the agreement of new loan conditions. Once the terms have been renegotiated, the loan is no longer considered past due.

Risk Management continuously reviews renegotiated loans to ensure that all criteria are met and that future payments are likely to occur. These loans continue to be subject to an individual or collective impairment assessment, calculated using the loan's original effective interest rate.

Financial Guarantees

Issued financial guarantees are initially recognised at their fair value, being the premium (fee) received and subsequently measured at the higher of the unamortised balance of the related fees received and deferred, and the expenditure required to settle the commitment at the balance sheet date. The latter is recognised 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 recognised 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 Greece. The Bank is also exempt from any obligation for payment, withholding or collection of any tax or duty. Also no tax shall be levied on salaries or emoluments paid by the Bank to employees. These tax exemptions are enforced by the Headquarters Agreement of Article 12, and have been implemented by the Greek Government by virtue of the ratification of Law 2380/No.38/7.3.1996.

Other Provisions

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

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%) percent of the subscribed capital including all paid, unpaid but payable, and unpaid but callable share capital.

Reserves

In accordance with the Establishing Agreement of the Bank the general reserve is created from the profits of the Bank, as mentioned above. It is maintained for meeting any unforeseeable risks or contingencies that may not qualify as provisions and is normally built-up from released provisioning charges during the year.

The revaluation reserve is created by the unrealised profit or loss from the available-for-sale investments of the Bank.

Retained Earnings

Retained earnings are the surpluses of the Bank and consist of amounts being allocated from prior year incomes and the unallocated current year's net income.

Netting of Assets and Liabilities

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

Revenues and Expenses

Interest income and expense are recorded in the income statement for all interest bearing instruments on an accrual basis using the effective interest rate method based on actual contractual terms, with the exception being those assets that are individually identified as impaired for which interest is recognised 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 amortised 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 amortised through the income statement using the effective interest rate method over the life of the loans. This calculation however, does not include costs that any other party is directly responsible for as: taxes, notary fees, insurance, registration, etc. In the case of early repayment, cancellation or acceleration, the outstanding deferred income from the related fees is recalculated taking into account the new maturity date. If the commitment expires without a loan being drawn down, the related fee is recognised as income on expiry.

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

Staff Retirement and Termination Benefits

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

- The first pillar is a defined benefit scheme financed entirely by the Bank. The Bank's contributions are determined on the basis of actuarial valuations using the projected unit credit method, performed annually by qualified, independent actuaries. Actuarial gains and losses are recognised as income or expense when the net cumulative unrecognised actuarial gains and losses at the end of the previous reporting year exceed 10% of the higher of the defined benefit obligation and the fair value of plan assets at that date. These gains or losses are recognised over the expected average remaining working lives of the employees participating in the plan.
- The second pillar is a defined contribution scheme to which both the employee and the Bank contribute equally at a rate of 0-7.5% of basic salary. Each employee determines his/her contribution rate and the mode of investment of the contributions.
- The third pillar is a defined contribution scheme funded entirely by each employee, up to 40% of basic salary.

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

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

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

Government Grants

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

Operating Leases

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

Use of Judgement and 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 judgements 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.

Actual results could differ from those estimates. Differences in judgement may affect impairment losses on loans and the staff retirement plan as referred in these notes. Such differences are believed not material and do not affect these financial statements.

New Accounting Standards and Interpretations of IASB

A) New Pronouncements (New Standards, Amendments / Revisions to Standards or Interpretations) Effective 31 December 2008 Year End:

The following new interpretations became mandatory for the first time for the financial year beginning 1 January 2008, and are not relevant for the Bank.

IAS 39: Financial Instruments: "Recognition and Measurement" and IFRS 7 "Financial Instruments: Disclosures; Reclassification of Financial Assets" (effective from 1 July 2008 and cannot be applied retrospectively to reporting periods before the effective date).

The amendment to IAS 39 permits an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss ("FVTPL") category in particular circumstances. The amendment also permits an entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future. The amendments do not permit reclassification into FVTPL. The amendment to IFRS 7 relates to the disclosures required to financial assets that have been reclassified. The Bank did not reclassify any of its financial instruments in 2008.

IFRIC Interpretation 11: IFRS 2 – Group and Treasury Share Transactions.

This interpretation requires arrangements whereby an employee is granted options to buy equity shares, to be accounted for as equity-settled schemes by an entity even if the entity chooses or is required to buy those equity shares from another party, or the shareholders of the entity provide the equity instruments granted. The interpretation also extends to the way in which subsidiaries, in their separate financial statements, account for such schemes when their employees receive rights to equity instruments of the parent. This Interpretation applies to the way a Group's subsidiaries account, in their individual financial statements, for options granted to their employees to buy equity shares of the parent company. As the Bank did not grant such rights to its employees, this interpretation is not relevant.

IFRIC Interpretation 12: Service Concession Arrangements.

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

IFRIC Interpretation 14: IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction.

This interpretation provides guidance on how to assess the limit on the amount of surplus in a defined benefit scheme that can be recognised as an asset under IAS 19 Employee Benefits. It also explains how this limit, also referred to as the "asset ceiling test", may be influenced by a minimum funding requirement and aims to standardize current practice.

The Bank was not obligated to a minimum funding requirement from any country it operates for post-employee defined benefits and other long-term employee defined benefits. The Bank's defined benefit schemes are currently in deficit, consequently this interpretation will have no impact on the financial position or performance.

B) Certain new Standards, Amendments and Interpretations to Existing Standards have been Published that are Mandatory for Accounting Periods On or After 1 January 2009 or Later Periods and which the Bank has not Early Adopted, as follows:

IFRS 1: First-time Adoption of International Financial Reporting Standards and IAS 27, Consolidated and Separate Financial Statements as amended (effective for annual periods beginning on or after 1 January 2009).

The amendments to IFRS 1 allows an entity to determine the 'cost' of investments in subsidiaries, jointly controlled entities or associates in its opening IFRS financial statements in accordance with IAS 27 or using a deemed cost. The amendment to IAS 27 requires all dividends from a subsidiary, jointly controlled entity or associate to be recognised in the income statement in the separate financial statement. The amendment to IAS 27 will have to be applied prospectively. The new requirements affect only the parent's separate financial statement and do not have an impact on the consolidated financial statements. The Bank expects that this amendment will have no impact on its financial statements.

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

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

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

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

IFRS 7: Financial Instruments: Disclosures as amended (effective for annual periods beginning on or after 1 January 2009).

The amendment requires fair value measurements to be disclosed by the source of inputs, using the following three-level hierarchy: (a) quoted prices (unadjusted) in active markets for identical assets and liabilities (Level 1); (b) inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (as prices) or indirectly (derived from prices) (Level 2); (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (level 3). This information must be given by class of financial instrument. The amendment also revises specified minimum liquidity risk disclosures. This amendment will not have a significant impact on the Bank.

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

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

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

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

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

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

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

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

IAS 39: Financial Instruments: Recognition and Measurement and IFRIC 9, Reassessment of Embedded Derivatives as amended (effective for annual periods ending on or after 30 June 2009).

This amendment clarifies the accounting treatment of embedded derivatives for entities that make use of the Reclassification Amendment issued by the IASB in October 2008. The reclassification amendment allows entities to reclassify particular financial instruments out of the 'fair value through profit or loss' category in specific circumstances. These amendments to IFRIC 9 and IAS 39 clarify that on reclassification of a financial asset out of the 'fair value through profit or loss' category, all embedded derivatives have to be assessed and, if necessary, separately accounted for in financial statements. The amendments apply retrospectively and are required to be applied. This amendment is not relevant to the Bank.

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

This Interpretation requires customer loyalty award credits to be accounted for as a separate component of the sales transaction in which they are granted and therefore part of the fair value of the consideration received is allocated to the award credits and deferred over the period that the award credits are fulfilled.
The Bank did not have any customer loyalty programmes, where credits are awarded to customers, nor does it envision of any such schemes in the near future. Therefore, it is not applicable to the Bank's operations.

IFRIC 15: Agreements for the Construction of Real Estate (was issued on 3 July 2008 and is effective for annual periods beginning on or after 1 January 2009 and must be applied retrospectively).

This provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of IAS 11 'Construction Contracts' or IAS 18 'Revenue' and, accordingly, when revenue from such construction should be recognised. This interpretation will not have any impact on the financial statements of the Bank because it does not conduct real estate activity.

IFRIC 16: Hedges of a Net Investment in a foreign operation (effective for financial years beginning on or after 1 October 2008 and is to be applied prospectively).

This clarifies three main issues, namely:
• A presentation currency does not create an exposure to which an entity may apply hedge accounting. Consequently, a parent entity may designate as a hedged risk only the foreign exchange differences arising from a difference between its own functional currency and that of its foreign operation.
• Hedging instrument(s) may be held by any entity or entities within the group.
• While IAS 39, 'Financial Instruments: Recognition and Measurement', must be applied to determine the amount that needs to be reclassified to profit or loss from the foreign currency translation reserve in respect of the hedging instrument, IAS 21 'The Effects of Changes in Foreign Exchange Rates' must be applied in respect of the hedged item.

As the Bank does not have an investment in a foreign operation, consequently the interpretation does not have any impact on its financial position or performance.

IFRIC 17: Distributions of Non-cash Assets to Owners (effective for annual periods beginning on or after 1 July 2009).

This clarifies the following issues, namely:
• A dividend payable should be recognised when the dividend is appropriately authorised and is no longer at the discretion of the entity.
• An entity should measure the dividend payable at the fair value of the net assets to be distributed.
• An entity should recognise the difference between the dividend paid and the carrying amount of the net assets distributed in profit or loss.
• An entity to provide additional disclosures if the net assets being held for distribution to owners meet the definition of a discontinued operation.

The interpretation applies to pro rata distributions of non-cash assets except for common control transactions. It is to be applied prospectively and earlier application is permitted. The Bank is in the process of assessing the impact of this interpretation on its financial statements.

IFRIC 18: Transfers from Customers (effective for financial years beginning on or after 1 July 2009 and is to be applied prospectively. However, limited retrospective application is permitted).

This Interpretation is of particular relevance for the utility sector as it clarifies the accounting for agreements where an entity receives an item of PP&E (or cash to construct such an item) from a customer and this equipment in turn is used to connect a customer to the network or to provide ongoing access to supply of goods/services. The Bank is in the process of assessing the impact of this interpretation on its financial statements.

Improvements to International Financial Reporting Standards "IFRSs" 2008.

Improvements to IFRSs was issued on 22 May 2008 by the International Accounting Standards Board and is the first standard issued as part of its "Annual Improvements Process" and includes a number of minor changes to various IFRSs. The amendments are made to specify the contents of the rules and eliminate unintended inconsistencies among the standards. Most of the amendments become effective for fiscal years starting on or after 1 January 2009. The impacts of the first-time application of these amendments on the Bank's financial statements are currently being reviewed.

Risk Management

Risk is inherent in the Bank's activities but is managed through an ongoing process of identification, measurement and monitoring, and is 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 investment policy documents define the risk parameters to be observed by the Treasury in managing its exposures. Additional tables related to the Bank's risk management are included in the section "Notes to the Financial Statements". The Bank is exposed to risks identified in this section.

Financial Risk

The Bank 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.

Credit Risk

The Bank is subject to credit risk, which is 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 collective impairment or specific provision is evaluated and reconfirmed or adjusted. Responsibility for operations considered to be in jeopardy may be transferred from the original lending department to a corporate recovery team in order to most effectively manage the restructuring and recovery process.

Provision and reserve amounts are calculated each month using the Bank's IFRS compliant methodology, which is based on loan loss experiences in the BSEC countries banking systems. The loan loss data is updated semi-annually and provides objective evidence of impairment, using separately each country's risk profile adjusting it for current circumstances when necessary, upon which to estimate provisions for losses.

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

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
Cash and bank balances	5,223	5,320
Placements with financial institutions	454	-
Investment securities	200,694	100,448
Derivative financial instruments	961	238
Loans	606,746	465,632
Equity investments	9,765	7,890
Other assets	21,340	10,381
On-balance-sheet	**845,183**	**589,909**
Undrawn commitments	122,432	76,204
Total	**967,615**	**666,113**

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, covenants and comfort letters.

• Loans and Advancements. The Bank's Board of Directors approved guidelines for taking security under lending operations set the amounts and types of collateral and other credit enhancements. The main types of collateral that may be obtained by the Bank are: mortgages on properties and equipment, pledges of equity shares and investment instruments, assignment of rights on certain contracts, cash or blocked deposits and other third party guarantees. When needed, the Bank reassesses the change in the market value of collateral and, if necessary, requests the pledging of additional collateral in accordance with the relevant agreement.

• Other Financial Instruments. Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Investment securities, treasury bills and other eligible bills are generally unsecured.

Liquidity Risk

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

The table below presents the cash flows payable on financial liabilities placed into relevant maturity groups, based on the remaining period from the balance sheet 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 therefore do not match to the balance sheet.

Expressed in SDR (000)	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	**Total**
Borrowings	125,470	4,582	61,755	285,779	3,716	**481,302**
Payables and accrued interest		4,596	752			**5,348**
Deferred income	4,741					**4,741**
Financial liabilities at 31 December 2008	**130,211**	**9,178**	**62,507**	**285,779**	**3,716**	**491,391**
Borrowings	443	2,482	102,234	145,663	3,865	**254,687**
Payables and accrued interest		1,462	697			**2,159**
Deferred income	3,200					**3,200**
Financial liabilities at 31 December 2007	**3,643**	**3,944**	**102,931**	**145,663**	**3,865**	**260,046**

Market Risk

Market risk refers to the probability 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.

Foreign Exchange Risk

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

Interest Rate Risk

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

The Bank interest rate sensitivity analysis comprises of 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 minimising sensitivity. Secondly, there is the absolute rate earned on assets that are funded by the Bank's equity resources. The majority of these equity resources are currently invested in the Bank's loan portfolio at floating rates; therefore, subjecting earnings on equity resources to some degree of fluctuation. As the Bank matures and its balance sheet grows it is the intention that earnings on equity resources be stabilised by an increased investment in fixed rate instruments.

Sensitivity Analysis

The table below details the re-pricing gap by currency as end of 2008 and as end of 2007. A parallel upward or downward shift in the SDR curve of 50 basis points would have generated the maximum loss or gain of SDR 661 thousand and SDR 710 thousand, respectively.

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
United states dollar	69,800	82,000
Euro	51,700	43,000
Japanese yen	1,000	11,000
Pound sterling	7,800	1,000
Total re-pricing gap	130,300	137,000
Shift of 50 basis points in the SDR curve	**661**	**710**

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 reputational risk. The Bank has a low tolerance for material 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 ensure business continuity, the accuracy of information used internally and reported externally, and the expertise of the Bank's personnel and their adherence to policies and procedures covering all significant aspects of operational risks. Furthermore, insurance and security arrangements are in place to protect the physical and information infrastructures of the Bank, which are an integral part of its operational risk management.

Classification and Fair Value

The table below identifies the Bank's financial assets and liabilities in accordance with IAS 39 categories.

	At 31 December 2008					
Expressed in SDR (000)	Held-to-maturity	Derivatives held for hedging	Loans and receivables	Available-for-sale	At amortised cost	**Carrying amount**
Assets						
Cash and bank balances					5,223	**5,223**
Placements with financial institutions					454	**454**
Investment securities	165,857			34,837		**200,694**
Derivative financial instruments		961				**961**
Loans			606,746			**606,746**
Impairment losses on loans			(30,838)			**(30,838)**
Equity investments				9,765		**9,765**
Other assets			21,340			**21,340**
Total financial assets	**165,857**	**961**	**597,248**	**44,602**	**5,677**	**814,345**
Liabilities						
Borrowings					459,295	**459,295**
Payables and accrued interest					5,348	**5,348**
Deferred income					4,741	**4,741**
Total financial liabilities	**0**	**0**	**0**	**0**	**469,384**	**469,384**

Expressed in SDR (000)	Held-to-maturity	Derivatives held for hedging	Loans and receivables	Available-for-sale	At amortised cost	**Carrying Amount**
	At 31 December 2007					
Assets						
Cash and bank balances					5,320	**5,320**
Placements with financial institutions						**0**
Investment securities	55,886			44,562		**100,448**
Derivative financial instruments		238				**238**
Loans			465,632			**465,632**
Impairment losses on loans			(25,846)			**(25,846)**
Equity investments				7,890		**7,890**
Other assets			10,381			**10,381**
Total financial assets	**55,886**	**238**	**450,167**	**52,452**	**5,320**	**564,063**
Liabilities						
Borrowings					231,795	**231,795**
Payables and accrued interest					2,159	**2,159**
Deferred income					3,200	**3,200**
Total financial liabilities	**0**	**0**	**0**	**0**	**237,154**	**237,154**

Capital Management

The Bank's initial authorised share capital was SDR 1 billion, which is fully subscribed by the shareholding states. In December 2007 the Board of Governors approved a tripling of the Bank's authorised share capital to SDR 3 billion and authorised the offering of SDR 1 billion to the existing Member States for subscription, with the objective of increasing subscribed capital to a total of SDR 2 billion. This increase will allow 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 shareholding 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 authorised share capital has not yet been allocated.

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, 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 is approximately SDR 1.050 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.

Notes to the Financial Statements

For the year ended 31 December 2008

1. Segment Reporting

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

	2008			2007		
Expressed in SDR (000)	Lending	Treasury	Total	Lending	Treasury	Total
Income statement						
Interest income	35,417	6,960	42,377	27,856	3,594	31,450
Fees and commission income	3,138	-	3,138	2,504	2	2,506
Total segment revenues	38,555	6,960	45,515	30,360	3,596	33,956
Less: interest expense	(15,542)	(820)	(16,362)	(6,564)	(931)	(7,495)
Less: fees and commission expense	(492)	-	(492)	(478)	-	(478)
Net fair value, foreign exchange and other	494	(170)	324	(37)	103	66
Less: administrative expenses	(10,598)	(651)	(11,249)	(10,462)	(510)	(10,972)
Less: depreciation and amortisation	(238)	(70)	(308)	(203)	(71)	(274)
Segment income before impairment	12,179	5,249	17,428	12,616	2,187	14,803
Impairment losses on loans	(4,388)	-	(4,388)	(5,706)	-	(5,706)
Net income for the year	**7,791**	**5,249**	**13,040**	**6,910**	**2,187**	**9,097**
Balance sheet						
Segment assets	607,712	207,332	815,044	458,814	106,006	564,820
Segment liabilities	468,930	454	469,384	236,407	747	237,154
Members' equity	-	-	345,660	-	-	327,666
At 31 December			**815,044**			**564,820**

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

2. Interest and Similar Income

Interest and similar income is analysed as follows:

Expressed in SDR (000)	Year to 31 December 2008	Year to 31 December 2007
From loans	35,417	27,856
From placements with financial institutions	982	945
From investment securities available-for-sale	1,955	2,027
From investment securities held-to-maturity	3,278	506
From derivative financial assets at fair value	745	116
Interest and similar income	**42,377**	**31,450**

3. Interest and Similar Expense

Interest and similar expense is analysed as follows:

Expressed in SDR (000)	Year to 31 December 2008	Year to 31 December 2007
From borrowed funds	14,676	6,506
From derivative financial liabilities at fair value	685	794
Other charges	1,001	195
Interest and similar expense	**16,362**	**7,495**

4. Fees and Commission Income

Fees and commission income is analysed as follows:

Expressed in SDR (000)	Year to 31 December 2008	Year to 31 December 2007
Front-end fees	1,598	1,284
Commitment fees	503	265
Management fees	148	151
Appraisal fees	9	57
Prepayment/cancellation fees	404	277
Other	476	472
Fees and commission income	**3,138**	**2,506**

The deferred income balance as of 31 December 2008 was SDR 4,741 thousand and as of 31 December 2007 was SDR 3,200 thousand. Such amounts are recognised in the income statement over the period from disbursement to repayment of the related loan in accordance with IAS 18.

5. Fees and Commission Expense

Fees and commission expense is analysed as follows:

Expressed in SDR (000)	Year to 31 December 2008	Year to 31 December 2007
Appraisal fees	16	6
Other expenses	476	472
Fees and commission expense	**492**	**478**

6. Administrative Expenses

Administrative expenses is analysed as follows:

Expressed in SDR (000)	Year to 31 December 2008	Year to 31 December 2007
Salaries and benefits	7,475	7,553
Staff retirement plan	1,188	1,323
Other administrative expenses	3,361	2,824
Total	12,024	11,700
Host country reimbursement	(775)	(728)
Administrative expenses	**11,249**	**10,972**

The average number of staff employed during the year was 99 (2007: 99). The number of staff at 31 December 2008 was 98 (2007: 99).

7. Impairment Losses on Loans

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

Expressed in SDR (000)	Collective	Specific	Total
At 1 January 2007	14,321	6,696	21,017
Charge for the year	5,109	604	5,713
Against amounts written off	(7)	-	(7)
Foreign exchange adjustments	(539)	(338)	(877)
At 1 January 2008	18,884	6,962	25,846
Charge for the year	4,388	-	4,388
Foreign exchange adjustments	431	173	604
At 31 December 2008	**23,703**	**7,135**	**30,838**

At 31 December 2008 the Bank categorised one loan as impaired. The total exposure amounts to SDR 7,135 thousand and the provision on this asset amounted to SDR 7,135 thousand, as collateral held is estimated not to have significant value.

8. Derivative Financial Instruments

The table below shows outstanding forward foreign exchange contracts the Bank had engaged. The first column shows the sum of notional amounts, which is the amount of a derivative's underlying asset, and is the basis upon which changes in the value is measured. The second column is the sum of mark to market revaluations.

	At 31 December 2008		At 31 December 2007	
Expressed in SDR (000)	Notional amount	Fair value	Notional amount	Fair value
Currency swap purchases	25,236	25,299	35,761	35,865
Currency swap sales	24,290	24,338	35,684	35,627
Derivative financial instruments	**946**	**961**	**77**	**238**

9. Loans

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

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
At 1 January	465,632	295,072
Disbursements	317,133	373,181
Less: repayments	(184,279)	(194,402)
Foreign exchange movements	8,260	(8,098)
Written off	-	(121)
At end of year	606,746	465,632
Less: impairment losses on loans	(30,838)	(25,846)
Loans net of impairment	**575,908**	**439,786**

The Bank classifies loan facilities as either standard, overdue, doubtful or non-performing. Non-performing are those that are impaired and which associated interest is not being accrued. As of 31 December 2008 all loan facilities are classified as standard and there is one that is impaired.

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

10. Equity Investments

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

			At 31 December 2008		At 31 December 2007	
Expressed in SDR (000)	% of investment	Total net Equity	Cost	Fair Value	Cost	Fair Value
SEAF Trans-Balkan Fund LLC	18.33	3,982	-	894	63	1,104
Micro Finance Bank of Azerbaijan	20.00	11,186	3,232	3,691	1,462	1,462
Transgaz Romania	0.72	125,693	497	497	1,571	1,571
Balkan Accession Fund	9.09	22,551	2,894	3,106	1,852	1,852
Teleset Networks	6.1	25,969	2,699	1,577	1,901	1,901
Available-for-sale			**9,322**	**9,765**	**6,849**	**7,890**

The valuation of such investments, which are unlisted, has been based on their latest audited accounts as of the 31 December 2007, with the exception of the Balkan Accession Fund which was last audited as of 31 December 2006.

An increase of SDR 139 thousand since the acquisition of the investments was due to an unrealized gain in fair value, attributable to the Bank's participation. During the year the Bank has received dividend income of SDR 46 thousand and has realized gains of SDR 475 thousand. At 31 December 2008 the Bank has no engagement in any equity investments that are held for trading.

The Bank has a committed amount of SDR 4,895 thousand towards the above entities share capital, which as of 31 December 2008 has not been called-up. Further analysis of the equity investment portfolio is presented in the following note "Operational analysis".

As at 31 December 2008 the Bank has only one equity investment where it holds 20 per cent of the investee share capital, but does not seek to exert significant influence.

11. Operational Analysis

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

Expressed in SDR (000)	At 31 December 2008		At 31 December 2007	
	Outstanding disbursements	Undrawn commitments	Outstanding disbursements	Undrawn commitments
Analysis by instrument				
Loans	606,746	117,537	465,632	69,813
Equity investments	9,765	4,895	7,890	6,391
At end of year	**616,511**	**122,432**	**473,522**	**76,204**
Analysis by country				
Albania	38,574	2,269	-	-
Armenia	36,836	6,902	21,967	1,156
Azerbaijan	33,308	18,019	21,371	6,071
Bulgaria	37,860	8,277	33,506	5,618
Georgia	17,573	3,246	16,705	1,901
Greece	27,513	-	33,535	-
Moldova	9,414	2,723	10,695	2,795
Romania	5,683	-	17,025	-
Russia	184,232	-	107,547	12,037
Turkey	73,498	62,273	74,887	19,773
Ukraine	148,021	13,829	133,328	20,462
Regional	3,999	4,894	2,956	6,391
At end of year	**616,511**	**122,432**	**473,522**	**76,204**
Analysis by sector				
Financial institutions	250,127	54,363	151,752	17,132
General industries*	233,624	62,968	216,628	33,226
Energy and infrastructure	132,760	5,101	105,142	25,846
At end of year	**616,511**	**122,432**	**473,522**	**76,204**

* Also includes transport and tourism.

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

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

12. Other Assets

Other assets is analysed as follows:

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
Accrued interest	10,130	8,625
Paid-in share capital not received	7,315	456
Advances and prepaid expenses	3,247	649
Pending pension plan	206	209
Rental reimbursement receivable*	379	375
Guarantee deposits	63	67
Other assets	**21,340**	**10,381**

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

13. Property and Equipment

Property and equipment is analysed as follows:

Expressed in SDR (000)	Buildings (leasehold)	Vehicle	Furniture and office accessories	Computers and office equipment	Total
Cost					
At 31 December 2006	151	32	354	1,157	1,694
Additions	11	58	28	116	213
Disposals	-	(32)	-	-	(32)
At 31 December 2007	162	58	382	1,273	1,875
Additions	1	-	21	109	131
At 31 December 2008	**163**	**58**	**403**	**1,382**	**2,006**
Accumulated depreciation					
At 31 December 2006	137	32	343	979	1,491
Charges for the year	9	7	6	86	108
Disposals	-	(32)	-	-	(32)
At 31 December 2007	146	7	349	1,065	1,567
Charges for the year	8	12	19	103	142
At 31 December 2008	**154**	**19**	**368**	**1,168**	**1,709**
Net book value					
At 31 December 2008	**9**	**39**	**35**	**214**	**297**
At 31 December 2007	16	51	33	208	308
At 31 December 2006	14	0	11	178	203

14. Intangible Assets

Intangible assets* is analysed as follows:

Expressed in SDR (000)	Total
Cost	
At 31 December 2006	1,535
Additions	29
At 31 December 2007	1,564
Additions	119
At 31 December 2008	**1,683**
Accumulated amortisation	
At 31 December 2006	948
Charges for the year	167
At 31 December 2007	1,115
Charges for the year	166
At 31 December 2008	**1,281**
Net book value	
At 31 December 2008	**402**
At 31 December 2007	449
At 31 December 2006	587

* Intangible assets comprises of computer software.

15. Borrowings

Borrowing facilities arranged at end of the year were SDR 463,833 thousand of which an amount of SDR 4,538 thousand was not used, as analysed below. In addition to medium or long-term borrowings, the Bank utilises short-term financing in the form of borrowings from commercial banks for cash management purposes. At 31 December 2008 the Bank had not issued any debt securities.

	At 31 December 2008		At 31 December 2007	
Expressed in SDR (000)	Amount used	Borrowings arranged	Amount used	Borrowings arranged
Euro	118,446	122,984	10,062	14,720
United States dollar	340,849	340,849	221,733	221,733
Total	**459,295**	**463,833**	**231,795**	**236,453**

The Interest rate on borrowings falls within a range of Euribor or USD Libor of + 0 to + 150 points. There is no collateral against the above borrowed funds. The fair value of the borrowings is approximately equal to carrying value.

As of 31 December 2008 the amount of SDR 454 thousand was included in “Placements with other financial institutions” that relates to the contribution received for the established Technical Cooperation Special Fund with the Development Bank of Austria. The equivalent liability has been included in the above borrowings.

16. Payables and Accrued Interest

Payables and accrued interest is analysed as follows:

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
Interest	4,134	1,214
Social insurance fund (IKA) contributions	25	23
Pension plan obligation	752	697
Suppliers and other accrued expenses	437	225
Payables and accrued interest	**5,348**	**2,159**

17. Share Capital

In accordance with Article 4 of the Establishing Agreement, the initial authorised share capital of the Bank is one billion SDR divided into one million shares having a par value of one thousand SDR each. The authorised capital stock of the Bank may be increased at such time and under such terms as may seem advisable.

The Bank's capital stock is divided into paid-in shares and callable shares. Payment for the paid-in shares subscribed to by members is made over a, or similar to, period of years in accordance with Article 6 of the Establishing Agreement or as determined in advance by the Bank. The same Article states that payment of the amount subscribed to 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, in which case the Bank is required to repurchase the former member's shares. 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, the Bank would be able to impose conditions and set dates in respect of payments for shares repurchased in accordance with Article 39 of the Establishing Agreement. Under Article 42 of the Establishing Agreement in the event of termination of the operations of the Bank, the liability of members for the unpaid portion of the subscribed capital of the Bank shall continue until all claims of creditors, including all contingent claims, have been discharged.

All participating members had fully subscribed to the initial authorised share capital in accordance with Article 5 of the Establishing Agreement. Subsequently, at the Sixth Annual Meeting of the Board of Governors held on 6 June 2004 three Member States, Armenia, Georgia and Moldova requested a fifty per cent reduction of their portion of subscribed capital, from 2% to 1% of the initial authorised capital, and the Board of Governors approved their request. On 5 October 2008 the new shares offered in the same structure as the initial authorised share capital, in the amount of SDR 1 billion were fully subscribed by the Member States. Furthermore, Azerbaijan also subscribed to the 3% of the initial authorised share capital that remained unallocated, while Romania subscribed both to their allocation of new shares and to those of Georgia. This subscription process followed a decision taken by the Board of Governors in December 2007 to triple the Bank's authorized capital to SDR 3 billion and to double the subscribed capital to SDR 2 billion, while leaving authorised capital of SDR 1 billion unallocated.

The issued share capital is analysed as follows:

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
Authorised share capital	3,000,000	1,000,000
Less: unallocated share capital*	(1,000,000)	(30,000)
Subscribed share capital	2,000,000	970,000
Less: shares not yet called	(1,400,000)	(679,000)
Less: shares called but not yet due	(300,000)	0
Called-up share capital	300,000	291,000
Advance against future call	32	35
Paid-in share capital	**300,032**	**291,035**

* Shares available to new or existing Member States.

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

At end of the year all Member States had fully settled the called up and due portion of their capital obligations. The balance of share capital due but not received at 31 December 2007 was SDR 456 thousand. The portion of the initial reallocated share capital that was subscribed is not required to be paid in full until the end of 2009.

The capital subscription status and voting power based on the paid amount, of each member at 31 December 2008 is analysed as follows:

		Subscribed	Callable	Payable	Paid	
Member	Shares	Expressed in SDR (000)				Voting Power
Albania	40,000	40,000	28,000	6,000	6,000	2.0%
Armenia	20,000	20,000	14,000	3,000	3,000	1.0%
Azerbaijan	100,000	100,000	70,000	15,000	7,685	2.9%
Bulgaria	270,000	270,000	189,000	40,500	40,500	13.8%
Georgia	10,000	10,000	7,000	0	3,000	1.0%
Greece	330,000	330,000	231,000	49,500	49,500	16.9%
Moldova	20,000	20,000	14,000	3,000	3,000	1.0%
Romania	280,000	280,000	196,000	43,500	40,500	13.8%
Russian Fed.	330,000	330,000	231,000	49,500	49,500	16.9%
Turkey	330,000	330,000	231,000	49,500	49,500	16.9%
Ukraine	270,000	270,000	189,000	40,500	40,500	13.8%
Total	**2,000,000**	**2,000,000**	**1,400,000**	**300,000**	**292,685**	**100.0%**

Basic earnings per share is calculated by dividing the net income for the year attributable to ordinary share holders of the Bank by the weighted average number of ordinary shares outstanding during the year.

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
Net income attributable to ordinary share holders of the Bank	13,040	9,097
Weighted average number of ordinary shares for basic earnings per share	293,350	291,000
Basic earnings per share in SDR	**0.044**	**0.031**

18. Reserves

Reserves is analysed as follows:

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
General	20,494	16,686
Available-for-sale revaluation	(2,185)	1,858
Reserves	**18,309**	**18,544**

An amount of SDR 3,808 thousand has been appropriated to the general reserve from retained earnings. Furthermore, the revaluation reserve has been adjusted relating to changes in fair value for an unrealized loss of SDR 4,043 thousand.

19. Cash and Cash Equivalents

Cash and cash equivalents are analysed as follows:

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
Cash	1	1
Bank balances/placements and/or investments:		
Up to 1 month	171,533	61,205
Cash and cash equivalents	**171,534**	**61,206**

The commercial paper held in the Bank's portfolio was rated at a minimum of A1 by Standard & Poors or P1 by Moody's, in accordance with internal financial policies.

20. Analysis by Rating Agency

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

	2008				
Expressed in SDR (000)	Aaa – Aa3	A1 – A3	Baa1 – Baa3	Unrated	Total
Analysis by Moody's rating					
Cash and bank balances	5,223	-	-	-	5,223
Placements with financial institutions	454	-	-	-	454
Investment securities	20,541	175,816	4,337	-	200,694
Equity investments	-	-	-	9,765	9,765
At 31 December	**26,218**	**175,816**	**4,337**	**9,765**	**216,136**
Of which issued by					
Governments	-	9,959	4,337	-	14,296
Corporates	20,541	165,857	-	9,765	196,163
Deposits at banks	5,677	-	-	-	5,677
At 31 December	**26,218**	**175,816**	**4,337**	**9,765**	**216,136**
Of which classified as					
Available-for-sale	20,541	9,959	4,337	9,765	44,602
Held-to-maturity	-	165,857	-	-	165,857
Amortised cost	5,677	-	-	-	5,677
At 31 December	**26,218**	**175,816**	**4,337**	**9,765**	**216,136**

	2007				
Expressed in SDR (000)	Aaa – Aa3	A1 – A3	Baa1 – Baa3	Unrated	Total
Analysis by Moody's rating					
Cash and bank balances	5,320	-	-	-	5,320
Placements with financial institutions	-	-	-	-	0
Investment securities	27,907	67,929	4,612	-	100,448
Equity investments	-	-	-	7,890	7,890
At 31 December	**33,227**	**67,929**	**4,612**	**7,890**	**113,658**
Of which issued by					
Governments	-	12,043	4,612	-	16,655
Corporates	27,907	55,886	-	7,890	91,683
Deposits at banks	5,320	-	-	-	5,320
At 31 December	**33,227**	**67,929**	**4,612**	**7,890**	**113,658**
Of which classified as					
Available-for-sale	27,907	12,043	4,612	7,890	52,452
Held-to-maturity	-	55,886	-	-	55,886
Amortised cost	5,320	-	-	-	5,320
At 31 December	**33,227**	**67,929**	**4,612**	**7,890**	**113,658**

21. Currency Risk

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

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

Expressed in SDR (000)	United States dollar	Euro	Japanese yen	Pound sterling	Other	Special drawing right	**Total**
Assets							
Cash and bank balances	4,585	312	43	222	61		**5,223**
Placements with financial institutions		454					**454**
Investment securities	49,938	102,967	21,536	26,253			**200,694**
Derivative financial instruments						961	**961**
Loans	468,086	138,660					**606,746**
Impairment losses on loans	(26,850)	(3,988)					**(30,838)**
Equity investments	2,842	1,984		751	4,188		**9,765**
Other assets	7,533	2,939		102		10,766	**21,340**
Property and equipment						297	**297**
Intangible assets						402	**402**
Total assets	506,134	243,328	21,579	27,328	4,249	12,426	**815,044**
Liabilities and Equity							
Borrowings	340,849	118,446					**459,295**
Payables and accrued interest	3,336	1,915	97				**5,348**
Deferred income						4,741	**4,741**
Members' equity						345,704	**345,660**
Total liabilities and equity	344,185	120,361	97	0	0	350,401	**815,044**
Net assets (liabilities)	161,949	122,967	21,482	27,328	4,249	(337,975)	**0**
Derivative financial instruments	(23,459)	908	22,972	1,420	(880)	(961)	**0**
Net currency balance at 31 December 2008	**138,490**	**123,875**	**44,454**	**28,748**	**3,369**	**(338,936)**	**0**
Correct SDR weights *	139,072	126,128	44,769	28,967	0	338,936	
Currency position at 31 December 2008	(582)	(2,253)	(315)	(219)	3,369	0	
Net currency balance at 31 December 2007	**132,426**	**125,128**	**33,712**	**37,721**	**666**	**(329,653)**	**0**

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

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

22. Liquidity Risk

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

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

Expressed in SDR (000)	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Maturity undefined	**Total**
Assets							
Cash and bank balances	5,223						**5,223**
Placements with financial institutions	454						**454**
Investment securities	165,857			34,837			**200,694**
Derivative financial instruments	961						**961**
Loans	5,990	22,386	116,951	376,507	84,912		**606,746**
Impairment losses on loans						(30,838)	**(30,838)**
Equity investments						9,765	**9,765**
Other assets	3,419	10,543	7,315			63	**21,340**
Property and equipment						297	**297**
Intangible assets						402	**402**
Total assets	181,904	32,929	124,266	411,344	84,912	(20,311)	**815,044**
Liabilities and Equity							
Borrowings	123,225		55,185	280,431		454	**459,295**
Payables and accrued interest		4,596	752				**5,348**
Deferred income	4,741						**4,741**
Members' equity						345,660	**345,660**
Total liabilities and equity	127,966	4,596	55,937	280,431	0	346,114	**815,044**
Liquidity position at 31 December 2008	**53,938**	**28,333**	**68,329**	**130,913**	**84,912**	**(366,425)**	**0**
Liquidity position at 31 December 2007	**79,514**	**33,940**	**4,167**	**159,745**	**67,432**	**(344,798)**	**0**

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

23. Interest Rate Risk

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

	Interest bearing						
Expressed in SDR (000)	Up to 1 month	From 1 month to 3 months	From 3 months to 1 year	From 1 year to 5 years	Over 5 years	Non-interest bearing	**Total**
Assets							
Cash and bank balances	5,222					1	**5,223**
Placements with financial institutions	454						**454**
Investment securities	165,857			34,837			**200,694**
Derivative financial instruments						961	**961**
Loans	117,386	279,403	204,601	5,356			**606,746**
Impairment losses on loans						(30,838)	**(30,838)**
Equity investments						9,765	**9,765**
Other assets						21,340	**21,340**
Property and equipment						297	**297**
Intangible assets						402	**402**
Total assets	288,919	279,403	204,601	40,193	0	1,928	**815,044**
Liabilities and Equity							
Borrowings	178,410	253,202	27,683				**459,295**
Payables and accrued interest						5,348	**5,348**
Deferred income						4,741	**4,741**
Members' equity						345,660	**345,660**
Total liabilities and equity	178,410	253,202	27,683	0	0	355,749	**815,044**
Interest rate risk at 31 December 2008	**110,509**	**26,201**	**176,918**	**40,193**	**0**	**(353,821)**	**0**
Interest rate risk at 31 December 2007	**155,345**	**4,278**	**131,636**	**48,345**	**0**	**(339,604)**	**0**

24. Staff Retirement Plan

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

Defined Benefit Scheme

The defined benefit scheme covers all eligible employees of the Bank. A qualified actuary performs an actuarial valuation of this scheme at each end of year using the projected unit method, which is rolled forward to the following year accounts. The most recent valuation date was 31 December 2008. The present value of the defined benefit obligation and current service cost was calculated using the projected unit credit method.

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
Amounts recognised in the balance sheet		
Present value of the defined benefit obligations	4,021	3,632
Fair value of plan assets	(4,388)	(4,268)
	(367)	(636)
Unrecognised actuarial gains (losses)	1,119	1,333
Net liability	752	697
Expenses for the year	701	849
Past service obligation	(77)	209
Contributions paid	(624)	(1,058)
At end of year	**752**	**697**
Amounts recognised in the income statement		
Current service cost	677	580
Interest cost	192	197
Expected return on plan assets	(185)	(165)
Amortisation of unrecognised (gain) loss	(55)	-
Past service obligation	72	237
Total included in administrative expenses	**701**	**849**
Principal actuarial assumptions used		
Discount rate	5.75%	5.50%
Expected return on plan assets	5.00%	4.20%
Future salary increases	3.50%	3.50%
Average remaining working life of employees	15 years	16 years

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

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
Major categories of plan assets		
Cash instruments	57.10%	41.50%
Fixed interest	26.70%	28.00%
Equities	12.95%	25.80%
Other	3.25%	4.70%
Reconciliation of plan assets		
Market value at 1 January	4,268	3,696
Expected return	185	165
Bank contributions	624	1,058
Employee contributions	-	-
Fund benefits	(106)	(447)
Expenses	(69)	(101)
Asset gain (loss)	(514)	(103)
Fair value of plan assets	**4,388**	**4,268**

The actual investment return on assets of the Fund was -4.76% (2007: -0.50%). 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 2009 will not materially differ from those paid in the current year.

Defined Contribution Scheme

The pension expense under this scheme was SDR 380 thousand (2007: SDR 363 thousand) and is included in “Administrative expenses”.

Greek State Social Insurance Fund

The pension expense of staff that is alternatively entitled to retirement benefits from this fund was SDR 107 thousand (2007: SDR 111 thousand) and is included in “Administrative expenses”.

25. Operating Leases

The Bank has entered into lease contracts for its Headquarters and other premises. These are operating leases and include renewal options and periodic escalation clauses. There is no commitment at end of period for non-cancellable lease contracts. Rental expenses for the year included in “Administrative expenses” totalled SDR 794 thousand (2007: SDR 734 thousand). The Hellenic Republic will grant the rental already being reimbursed amounting to SDR 775 thousand.

26. Related Parties

The Bank has the below related parties:

Key Management Personnel

Key management personnel comprise: the President, Vice Presidents and Secretary General. They are entitled to a staff compensation package that includes a salary, covered by medical insurance, participate in the Bank's retirement schemes and are eligible to receive other short term benefits. All amounts are paid in Euro which is the currency of the Host Country. The amounts paid to key management personnel in 2008 were SDR 875 thousand and in 2007 were SDR 844 thousand. Key management personnel do not receive post employment benefits, other long term benefits, termination benefits nor any share based payments.

The Board of Directors is not personnel of the Bank and do not receive any fixed term salaries nor any staff benefits.

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. At 31 December 2008 the Bank administered one special fund. Extracts from the audited financial statements is included under the "Summary of special fund".

27. Post–balance Sheet Events

In March 2009, the Management had decided to seek an issuance of a bond of SDR 182 million to further allow for the Bank's expansion. This followed the decision by the Board of Directors in November 2008 where the Bank may issue a bond. There are no other material post-balance sheet events that would require disclosure or adjustment to these financial statements.

28. Summary of Special Fund

The Bank administered and audited the Technical Cooperation Special Fund (the "Fund") whose assets and fund balance are not included in the Bank's balance sheet.

The objective of the Fund, which has been funded by the Hellenic Republic, is to contribute to the economic development of the Black Sea Region's Member Countries. The Fund extends technical assistance grants for preparation of high quality project documentation including business plans, feasibility studies and financial reporting methods and standards. The movement in the Fund for the years 2008 and 2007 is shown below.

Expressed in SDR (000)	At 31 December 2008	At 31 December 2007
Statement of movements		
Balance brought forward	361	581
Interest and other income	15	18
Less: disbursements	(1)	(274)
Less: operating expenses	-	(2)
Foreign exchange movements	(10)	38
Balance of available funds	**365**	**361**
Balance sheet		
Placements with other financial institutions	365	361
Total Assets	365	361
Unallocated fund balance	365	361
Total liabilities and contributor resources	**365**	**361**

Internal Control over External Financial Reporting

Responsibility for External Financial Reporting
Management's Responsibility

Management's Report Regarding the Effectiveness of Internal Controls over External Financial Reporting

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

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

Management is responsible for establishing and maintaining effective internal control over external financial reporting for financial presentations in conformity with IFRS. The system of internal control 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 control, including the possibility of human error and the circumvention of overriding controls. Accordingly, even an effective internal control system can provide only reasonable assurance with respect to financial statements. Furthermore, the effectiveness of an internal control system can change with circumstances.

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

The Bank has assessed its internal controls over external financial reporting for 2008. The Bank's assessment was based on the criteria for effective internal control over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Based upon this assessment, management asserts that, at 31 December 2008, the Bank maintained effective internal controls over its financial reporting as contained in the Financial Statements for 2008.

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 control over financial reporting, as set out on page 83.

Hayrettin Kaplan
President

Sophia Kassidova
Vice President Finance

Thessaloniki,Greece
10 April 2009

Internal Control over External Financial Reporting

Report of the Independent Auditors

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

We have audited Black Sea Trade and Development Bank ("the Bank") internal controls over financial reporting as at 31 December 2008 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.

Management is responsible for maintaining effective internal controls over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assertion over the effectiveness of the Bank's internal control over financial reporting, based on our audit.

We conducted our audit in accordance with the International Standard on Assurance Engagements (ISAE) 3000. Our audit included obtaining an understanding of internal control over financial reporting, evaluating the management's assessment and performing such other procedures as we considered necessary in the circumstances. We believe that our work provides a reasonable basis for our opinion.

A bank's internal controls over financial reporting are 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 controls 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 generally accepted accounting principles, and that receipts and expenditures of the bank are being made only in accordance with the authorisation of the bank's management; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised 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.

In our opinion, the Bank maintained effective internal control over financial reporting, in all material respects, as at 31 December 2008 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.

We have also audited, in accordance with International Standards on Auditing, the financial statements of the Bank and, in our report dated 10 April 2009, we have expressed an unqualified opinion.

Ernst & Young,

Athens, Greece
10 April 2009

Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the Black Sea Trade and Development Bank (the "Bank"), which comprise the balance sheet as at 31 December 2008, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

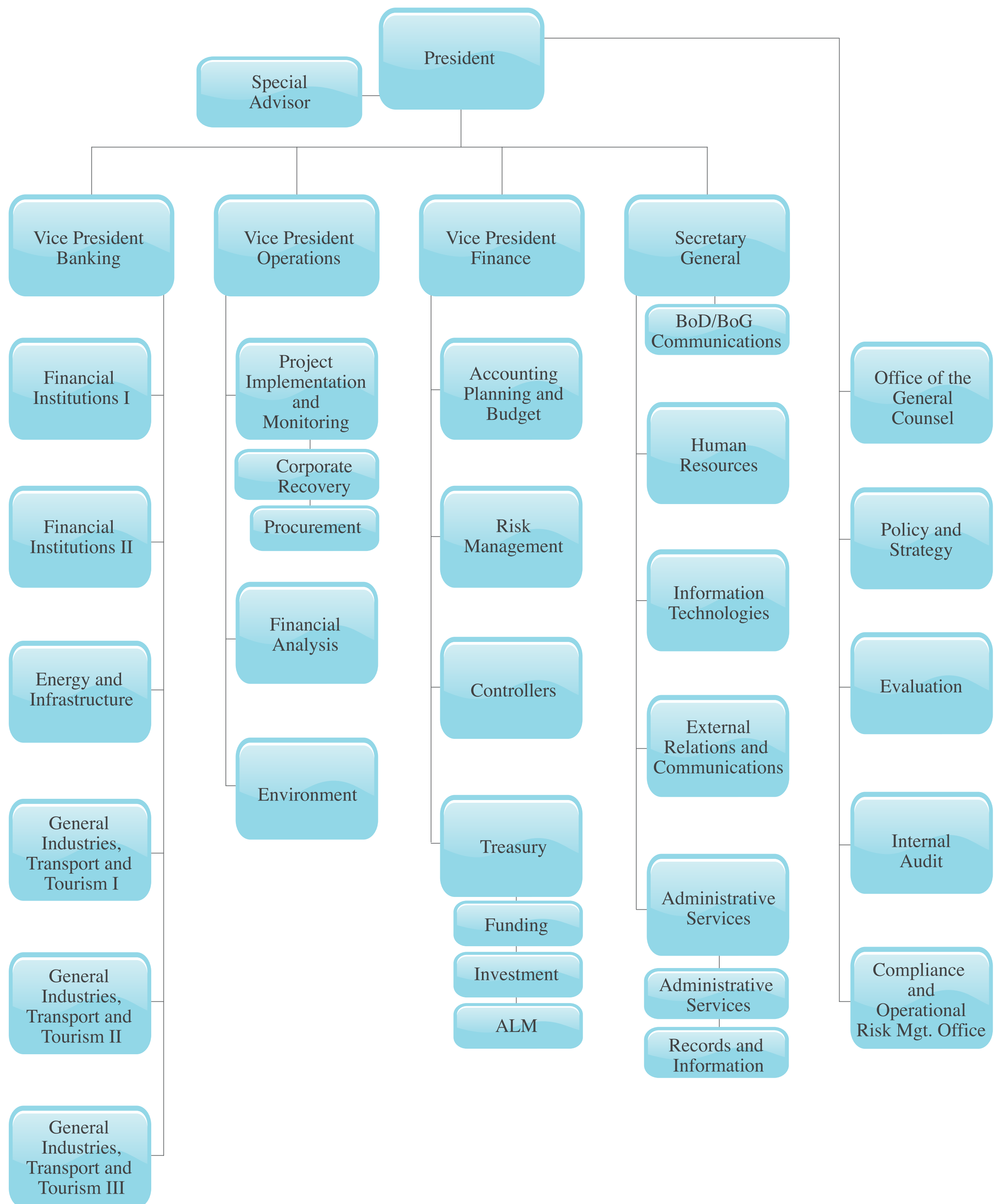
In our opinion, the financial statements present fairly, in all material respects, the financial position of the Black Sea Trade and Development Bank as of 31 December 2008, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

Ernst & Young,

Athens, Greece,
10 April 2009

Annex A

Organizational Chart



* As of 31 December 2008

Annex B

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Annual Report **Black Sea Trade And Development Bank**

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