BLACK SEA TRADE AND DEVELOPMENT BANK

MEDIUM-TERM STRATEGY

AND

BUSINESS PLAN

2011-2014

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LIST OF KEY ABBREVIATIONS

BSC – Balanced Score Card
BoD – Board of Directors
BoG – Board of Governors
CABEI – Central American Bank for Economic Integration
CAF – Andean Finance Corporation
CDB – Caribbean Development Bank
CEE – Central and Eastern Europe
CoEDB – Council of Europe Development Bank
DB – Data base
DEG – Deutsche Investitions und Entwicklungsgesellschaft (part of KfW Bankengruppe)
EBRD – European Bank for Reconstruction and Development
ECA – Export Credit Agency
EIB – European Investment Bank
EU – European Union
FMO – Netherlands Development Finance Company
Forex – Foreign Exchange
GDP – Gross Domestic Product
IFC – International Finance Corporation
IFI – International Financial Institutions
IFRS – International Financial Reporting Standards
KfW – Kreditanstalt für Wiederaufbau
LO – Learning Organization
MDB – Multilateral Development Bank
MIS – Management Information System
NIB – Nordic Investment Bank
PCS – Preferred Creditor Status
Proparco – Investment and Promotions Company for Economic Cooperation (Groupe Agence Française de Développement)
SDR – Special Drawing Rights
SME – Small and Medium Size Enterprise
SWOT – Strengths, Weaknesses, Opportunities and Threats

EXECUTIVE SUMMARY

The Black Sea Trade and Development Bank has completed eleven years of operations during which it has achieved financial sustainability and a high quality portfolio. It has to a large degree met shareholder expectations and enjoys their strong support with the entire portion of initially authorized and subscribed capital fully paid. In 2008, the Board of Governors authorized a three fold increase in the authorized capital, and a doubling of the subscribed capital to SDR 2 billion, which was subscribed by, and allocated to, Founding Members. In 2010 the first installment is due to be paid, and progress to date is encouraging. The Bank has also increased cooperation with other development institutions active in the Black Sea region and has earned recognition from the development community. The Bank's investment grade risk rating from Moody's was upgraded to A3 in September 2010. In short, the Bank has successfully proven the validity of the concept of a regional development finance institution in the Black Sea region which supports cooperation among and economic progress in the Founding Member States.

Despite these achievements, the Bank cannot afford to be complacent in the current period of unsettling risk and uncertainty. The region in which the Bank operates is highly interconnected with the rest of the world, with a dependence on foreign capital and foreign demand, which rendered it vulnerable during the global financial crisis. Internally, there are also a number of challenges which the Bank needs to address.

In June 2009, the Bank's Board of Governors approved the *Long Term Strategic Framework – "The Next Ten Years"* which laid out the Bank's vision and strategic objectives and provided general direction for the institution. The vision is that: "By 2020, the BSTDB intends to be recognized globally, and by its shareholders in particular, as one of the prominent development finance institutions for the Black Sea region, providing well-focused development assistance and solutions. Thus, BSTDB would become a preferred partner in the region for clients, multilateral and bilateral donors and other partners in development."

The Bank in its Medium-term Strategy and Business Plan 2011-2014 (MTSBP) aims to advance this vision and translate the Long Term Strategy's strategic objectives into goals over the coming four year period and to adopt the ways and means to achieve them.

This MTSBP projects that the Bank's portfolio of outstanding operations will grow from SDR 600 million at end-2010 to SDR 1.0 billion at end-2014. The SDR 1.0 billion target reflects a manageable rate of growth in new operations and outstanding amounts, with due respect being given to the continuing volatile conditions in the credit markets and the economic stress suffered by many Member States.

The Bank will seek to diversify sectors of operation, gradually shifting to more public sector or quasi-public sector and related cross-country activities. Moreover, attention shall be given to continuing promotion of intra-regional trade and financing of operations based on intra-regional investment. See Annex 1 for a summary of goals, operational targets, and key indicators.

Cooperation with IFIs, donors and other external actors will form an increasingly important mode of operation for BSTDB, as it seeks to expand partnerships. The development of partnerships in part responds to the increased interest of external actors in the region, but it is also the result of a Bank strategy of increased outreach, in order to achieve greater leveraging of own resources, improved risk sharing and the establishment of new networks of financing. BSTDB intends to extend resource mobilization beyond just financing of operations, since policy

coordination and consistency are also crucial features in generating value for the Bank's shareholders and for regional clients. Thus, the Bank will be more active in dialogue with partners, as a way to mobilize knowledge resources, share experiences, and engage in promotional activities both for the Bank and for the Black Sea region.

One solution to sustain and even enhance growth is to increase the subscribed capital by admitting a non-regional internationally reputed and AAA rated institutional shareholder (a development finance institution), in conformity with the provisions of the Agreement Establishing the Bank, and the provisions of the Long-term Strategy. The benefit from a higher level of capital contributed by a AAA rated development finance institution is threefold: (i) the amount paid-in, which is considered free capital, on which the Bank would earn income; (ii) the callable capital, assumed by rating agencies as good as paid-in capital, which improves the ratios and permits higher leverage; and (iii) the accompanying rating upgrade, which both reduces the overall cost of borrowed funds and increases the availability of such funds. Consequent to such a capital increase, the Bank would enjoy improved prospects for dynamic growth of its operations, and the relevance of the Bank would be enhanced to its shareholders.

In the absence of a AAA rated institutional shareholder, membership of which remains a high priority, the Bank targets achieving at least an A2 risk rating from Moody's by 2014. It would also seek to receive a second rating from a leading credit rating agency.

Internally, in line with its core objective to develop an institutional culture of transparency, communication, cooperation, and sound corporate governance, the Bank is committed to develop and implement the necessary systems and controls to achieve improvement in overall risk management and Human Resources Management.

To be able to measure the degree of achievement of its objectives, the Bank has updated and revised certain broad performance indicators which it used in the preceding planning period, and which will help to gauge progress against planned targets.

I. CONTEXT ANALYSIS

A. Prospects for the World Economy

The first half of 2010 raised optimism that the worst effects of the global crisis are over, and that the world economy would recover rapidly. The view was supported by resilience in the US, strong growth in China and industrial production growth in the Eurozone at an annualized rate in excess of 10 percent. However, the result of government intervention in 2009 globally to prevent the financial sector collapse resulted in high levels of public debt. According to BIS, the aggregate public debt of advanced economies is set to rise from 76 percent of GDP at the start of the financial and economic crisis in 2007 to more than 100 percent by 2011. This worrying trend initiated a crisis in the Eurozone in early 2010 in which the most vulnerable states in the Eurozone's periphery came under attack from markets, with the vulnerability defined in terms of factors such as the size of fiscal deficits and current account deficits, debt levels (public and private), and the fact that in a currency union such as the Eurozone it is not possible for countries to undertake currency devaluation in order to improve their competitiveness. More recently, however, the IMF reported that the signs of economic recovery are receding and global imbalances increasing, with third quarter data indicating increased risks to the downside, and warned that growth in the coming year might be anemic and uneven.

The European Union is the world's biggest economy. The worries of a sovereign debt crisis strengthened the determination of governments throughout Europe to adopt measures of fiscal austerity. The global financial crisis has exposed the weak links in the world's economy in general and in Europe's economy in particular. Some of the challenges the EU faces, however, are unique to it and caused, in part, by wide internal economic divergences. For the Eurozone, the crisis has revealed institutional deficiencies and functional limitations. These include immediate and long-term challenges related to the burden of debt, demographic decline and lower expected growth and are issues which require political decision, but political will is handicapped by differences of opinion concerning what the union is about. Furthermore, differences between the core countries of Germany and France as to what kind of closer cooperation and harmonization is desirable, and lack of consensus in what areas harmonization may be applicable, herald that the solution to the problem is not yet in sight. Attempts to rein in the public finances risk weakening growth, which make it more difficult for exporters in China and the US to resume growth as their export markets may show little demand.

The US economic outlook softened somewhat with risks having shifted to the downside. Slowing inflation, constrained household spending and contracting credit prompted the Federal Reserve to keep the benchmark lending rate near zero for an extended period. China's economic expansion eased signaling the possibility of a deeper slowdown, with external factors likely to determine its severity. Nevertheless, China's economy overtook Japan's as the world's second biggest this year, and the OECD estimates that it may account for a third of global growth.

On the supply side, credit markets still suffer from liquidity constraints. This results from a number of factors, including: (i) deleveraging pressures in the financial sector and the universal need to raise equity capital demanded by the new tighter financial sector regulations; (ii) central banks' need for exit strategies and liquidity withdrawal; and (iii) refinancing needs of banks around the world of more than USD 5 trillion of debts in the coming three years. This is a massive rollover that poses threats to financial stability and growth. One consequence is that, all

things being equal, the cost for banks to issue debt should rise, as should competition among banks for consumer deposits.

On the demand side, growing competition for resources is likely and there is a risk of high rated sovereigns crowding out lower rated sovereigns and the private sector. For the UK and the Eurozone, this will occur at the same time that fiscal austerity programs will be dampening growth. It is estimated that over the next three years Greece, Ireland, Italy, Portugal and Spain would need to raise approximately EUR 2 trillion collectively. They would need to do so as investor confidence is weakening and the spread between sovereign bonds issued by peripheral countries and Germany are widening Another trillion would be needed by emerging market sovereigns. Furthermore, the financing needs of the US and the UK, as well as other developed economies, will also add several trillion of new borrowing, especially if the US delays its own fiscal tightening.

High and growing demand for funding in both equity and debt also comes from Multilateral Development Banks, thus putting further stress on public finances and credit markets. A number have approved capital increases, including (i) the Asian Development Bank (ADB) which approved a tripling of its capital base to USD 165 billion last April (though only 4% of the increase would be paid-in capital) (ii) the European Bank for Reconstruction and Development (EBRD) which in February decided to augment its EUR 20 billion capital base by 50%, including EUR 9 billion in callable capital, (iii) the African members of the African Development Bank who want to triple its capital to USD 99 billion (6% would be paid-in), and (iv) the Inter-American Development Bank (IDB) and the World Bank which finalized their capital-increase plans ahead of their annual meetings in March and April respectively.

These developments put into perspective not just how challenging it will be to create growth going forward, but also suggest that access to credit will be tight and much more expensive in the future, and also show how artificial was the high growth fueled by easy credit during the boom years. The high levels of risk and uncertainty thus feed perceptions of the imminence of a double dip recession, and even if avoided, it is anticipated that world economic growth will be subdued while (i) unemployment will likely remain above its long-term sustainable level for several years, (ii) deflationary risks will remain significant in the short run, and (iii) consumer demand will be repressed.

Volatility, in particular in currency markets, is expected to remain high. The currency market volatility underscores a distinct possibility for a “currency war” of competitive devaluations, which would threaten the stability of the international monetary and trade system. Countermeasures by emerging market economies aimed at preventing massive capital inflows, which may appreciate their currencies and hurt exports, cannot thus be dismissed.

At present, inflationary pressures are very low. However, to counteract the concurrent tightening both in public finances and in credit markets, key central banks will most likely follow accommodative monetary policies, with very low rates for an extended period of time and possibly large quantitative easing programs. As a strong deterrent to such a policy move, the BIS stated that "the longer that policy rates in the major advanced economies remain low, the larger will be the distortions they create, both domestically and internationally." If, however, quantitative easing would be the policy tool of choice, towards the end of 2014 the risk of renewed inflationary pressures, and of a spike in interest rates, is a distinct possibility, in particular if the fiscal tightening measures fail to bring down debt to GDP ratios. In the

meantime, quantitative easing programs may fuel asset and commodity price bubbles, before feeding into outright inflation.

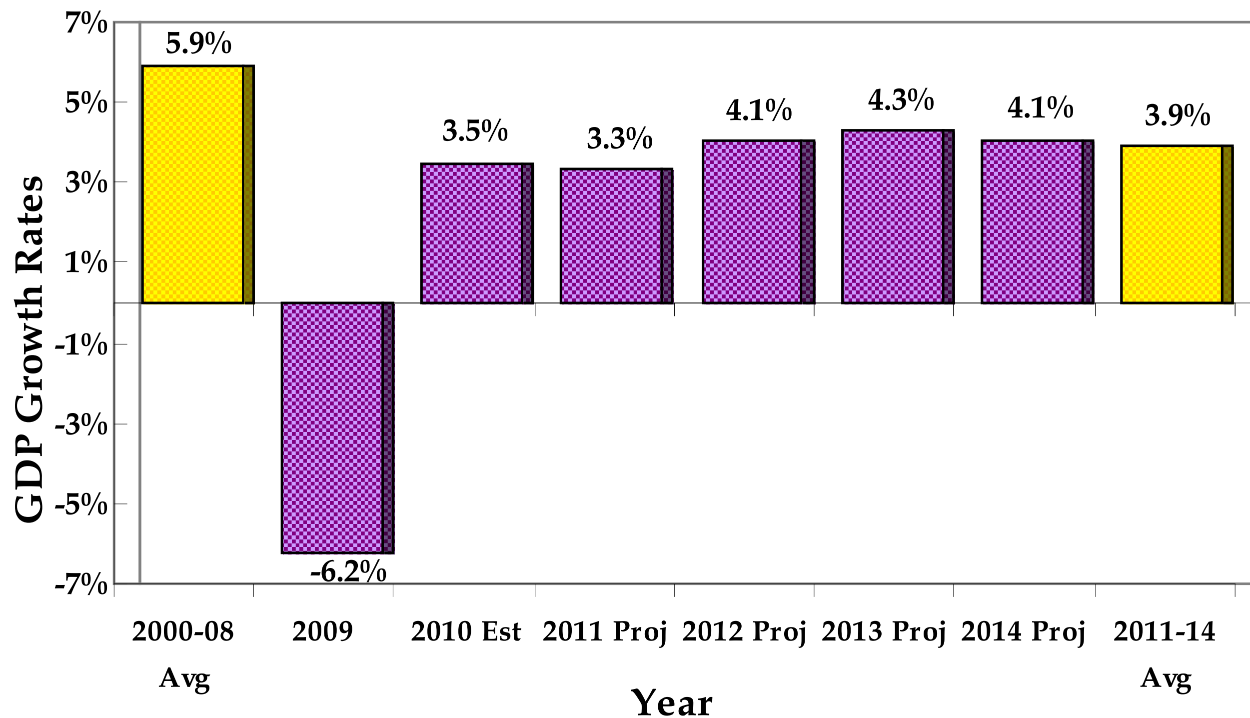
B. BLACK SEA REGION OPERATING ENVIRONMENT

Overview of Current Economic Situation in the Black Sea Region

Following the outbreak of the global financial crisis in September 2008, an economic downturn ensued which hit the greater Black Sea region particularly hard, imposing a painful recession. The crisis in the region brought to a close a period of robust growth between 2000-2008, during which real GDP growth averaged 6% per annum, and all countries experienced increases in prosperity and wealth.

The impact has been negative across the Black Sea region, although the extent of damage has varied from country to country. The biggest problem is the economic contraction which has reversed the trend of robust growth in previous years. Many businesses have failed, unemployment has jumped, and there are fears that poverty rates will rise once again. It is estimated that for 2009 the region suffered a contraction in real GDP on the order of -6.2%. While the recession brought a needed reduction in inflation levels and a correction to current account balances, these were not the result of a rebalancing of rising trade flows or improved export performance by deficit countries, but rather the unfortunate result of declines in trade, investment and financial flows brought about by the economic downturn.

Figure 1: Trends and Projections in Black Sea Region GDP: 1995-2014



Sources: National Statistical Agencies, IMF-IFS & EIU   Key: Avg = Average Est = Estimate Proj = Projection

Nevertheless, the worst of the crisis appears to be over in most countries, as the decline appears to have bottomed out in the second quarter of 2009, and by the last quarter of 2009 a number of economic indicators had turned positive. While there remains much uncertainty as well as the danger that new external shocks may yet set back recovery, growth prospects in the Black Sea region for 2010 improved, with the expectation that real growth will be approximately 3.5% of GDP. Such growth represents only the beginning of a recovery from the much larger contraction experienced in 2009, but the trend has picked up momentum and the solid performance of most regional countries generates guarded optimism about prospects for the 2011-2014 period.

Private consumption has picked up after slowing markedly in 2009, and the fact that private debt levels are low throughout the region bodes well for growth in future years. By way of contrast, public consumption will be weaker, as it rose during the recession in order to counteract the private decline and due to automatic ‘safety net’ factors. As a result, it will likely be constrained by the desire of countries to reduce fiscal deficits and fears that public debt levels may rise.

Similarly, public investment is unlikely to grow significantly due to fiscal constraints and debt concerns. This could become a key issue for many Black Sea countries since throughout the region infrastructure needs are large, and poor or worn out infrastructure represents a potential bottleneck to the post-crisis resumption of strong economic growth.

This is where the question of expectations for private investment enters the picture, and in many ways it represents the ‘great unknown’. On the one hand, the business environment in the region is favorable and open to investment, and Black Sea countries possess a highly skilled, flexible, and relatively inexpensive labor force. These factors are attractive for investors, as is the proximity of the region to the wealthy markets of western Europe, and the trend of strong and growing relations with these markets.

On the other hand, risk aversion in global markets remains high, and this limits the access of regional firms to financing, while it also raises costs. How long this will continue is unknown, but a return to the high volume, cheap financing of the 2005-08 period is exceedingly unlikely. In addition, economic recovery in the critical markets of western Europe is expected to be anaemic, limiting the capacity to absorb higher exports from the Black Sea region. And of course, there is always the risk of new exogenous shocks that in conjunction with the prevailing high levels of uncertainty often results in disproportionately negative impact for ‘emerging markets’ regions like the Black Sea.

With lending from foreign sources down and unlikely to return to pre-crisis levels, the economies of the Black Sea region will need to tap into their own (domestic) resource bases to a greater degree. Capital flight, a problem which returned perniciously during the financial crisis, is one area to target and the return of capital from abroad and increase in confidence of local financial systems will help mobilize domestic resources. Beyond that, local banks (and financial regulators) will need to ensure that in addition to shoring up their capital base, the lending activity of banks does not deviate in an unviable manner from their deposit base, and that growth results ‘organically’ with reference to the availability of resources, rather than in speculative form. More generally, governments will need to take measures to increase productivity and efficiency, as well as policies that may facilitate higher investment, both public and private. This should primarily take the form of structural reforms in sectors such as agriculture and energy, and should extend to creating open, competitive- and where necessary well regulated- environments throughout the various sectors of the economy.

An additional potential 'motor' for greater growth lies in the economic interaction of neighboring countries; that is, greater emphasis upon the development of regional economic relations. Despite some growth in intra-BSEC economic relations over the years, levels of investment, financing and trade are extremely modest in comparison to similar sub-regions (most notably, the Baltic Sea). This represents an area of huge untapped potential, with much scope for substantial growth in order for countries to achieve sustainable mutual gains, and to increase competitiveness, efficiency, and prosperity.

If private consumption becomes the main (or only) driver of growth, annual real GDP increases in the Black Sea region are likely to be in the 2-3% range. If governments pursue structural reforms dynamically, capital markets recover, and intra-regional economic potential is realized, private investment will flourish and improved GDP dynamics may permit greater public investment as well. Under such conditions GDP growth in the Black Sea region could sustainably return to annual real rates on the order of the 6% observed during the boom period.

The likeliest outcome lies in between, in the 4% range, driven by (i) a reasonable mix of policy measures, most prominently to ensure fiscal sustainability but likely lagging in terms of more difficult structural reforms (ii) continued improvements in the business environment, (iii) a recovery of capital markets- albeit to a more measured and higher margin equilibrium recovery, and (iv) greater exploitation of intra-regional trade and investment opportunities.

C. BANK INTERNAL ENVIRONMENT

C1. Review of Business Plan 2007-2010

Relative to the goals under the Action Plan of the MTSBP 2007-2010 the Bank achieved the following:

- The Board of Governors approved a three times increase in the authorized capital, of which a doubling of subscribed capital;
- The Bank received an upgrade in its credit rating from Moody's to A3, despite the negative impact on the region of the global financial and economic crisis;
- Single obligor has increased to 7.5% of paid-in capital, reserves and surpluses;
- A targeted functional reorganization has been implemented in 2007, including the abolition of the Office of the Chief Economist accompanied by a corresponding reallocation of tasks and responsibilities, the transfer of the Policy and Strategy Department to the President Division, the transfer of Procurement to PIMD, the establishment of a specialized Corporate Recovery function, the transfer of the BoD/BoG communication function to the Office of the Secretary General, and the establishment of a SAP position in the IT Department;
- Cooperation with other development finance institutions has improved, as reflected by the number of observers in the Bank, institutions where the Bank holds observer status, and cooperation agreements signed;
- The policy framework for Human Resources Management and its application procedures have been upgraded;

- The BoD approved the relevant policy allowing the Treasury to invest in financial instruments issued by various governments, agencies and institutions of Member States;
- Increased integration and upgraded availability and capabilities of the Management Information System (MIS) is under way;
- The Bank made progress with the development of a comprehensive balanced scorecard based work planning and performance appraisal system with a view to ensuring a balance between mandate and financial objectives;
- The share of small shareholding countries in the total portfolio of outstanding operations has increased to about 20%;
- The share of equity in the total portfolio of operations remained well below the 10% target.

C2. Portfolio Structure

Operational Portfolio Developments

As noted in the Mid-Term Review of the Medium-Term Strategy and Business Plan (MTSBP) for 2007-2010, during the 2007-2008 period, the Bank exceeded annual targets for new operations approved by the Bank's Board of Directors (BoD) and new Signed operations (a.k.a. 'Commitments') by a wide margin (See Table 1). The Bank took advantage of a benign market environment, and higher than anticipated demand for its products, and expanded its portfolio of operations rapidly. As a result the full four year targets for the MTSBP were largely met during this two year period. Indeed, the robust 2008 numbers were largely achieved in the first half of the year. Subsequently, the deterioration in global financial conditions and the outbreak of the financial crisis in September 2008 forced the Bank to bring new operations development temporarily to a halt and to proceed more cautiously in 2009 and 2010.

Table 1: Actual Operational Activity Versus 2007-2010 MTSBP Projections

SDR Million	BP Target BoD Approvals	Actual BoD Approvals	Actual as % of Target	BP Target for Signings	Actual Signings	Actual as % of Target
2007	183	430.5	235%	147	312.0	212%
2008	190	258.2	136%	161	297.9	185%
2009	200	145.6	73%	175	96.0	55%
2010*	200.0	148.1	74%	175.0	115.5	66%
2007-2010*	**773.0**	**982.3**	**127%**	**658.0**	**821.3**	**125%**

Note: A percentage above 100% means target was exceeded. A percentage below 100% means the target was not been met.
* For 2010, actual figures are as of end September.

The crisis caused a freezing of financial markets which was followed by an extended period of high risk aversion, tight credit availability, and substantially higher lending margins that continues through the first half of 2010. Under these conditions, the flow of private credit declined dramatically. AAA rated international financial institutions (IFIs) responded by increasing their 'counter-cyclical' financing activities significantly in order to offset a portion of

the private credit slowdown and mitigate some of the worst effects on Governments, banks and firms in recipient countries.

Unfortunately, the Bank was not in a position to play a similar counter-cyclical role to meet the increased regional demand for financing. Its Baa1 credit rating - which it held through most of the period of the 2007-10 MTSBP - put it at a distinct disadvantage relative to the AAA rated IFIs in terms of access to, and cost of, financing. In the face of high uncertainty, volatile markets, and significant liquidity risks, the Bank responded by seeking to preserve its achievements to date and to safeguard the interests of its shareholders, so as to be able to fulfill its mandate on a long term basis. In practice, this meant a slowdown in new lending activities, caution with respect to provision of financing, and a shift in focus towards maintaining the high quality of the existing portfolio and seeking to consolidate activities and improve effectiveness after the years of rapid operational growth. This strategy was vindicated by the avoidance of problem projects during the crisis, the achievement of sustained profitability throughout the 2007-10 period, and the upgrade in BSTDB's credit rating from Moody's in September 2010 to A3.

In the first half of 2009 new lending activity was minimal. After successfully launching its inaugural bond issue in May, however, and despite the continuing climate of uncertainty, the Bank decided to gear up its operational activities in the second half of 2009 in order to reach out to regional clients and provide support to markets which were still suffering disproportionately from post-crisis risk aversion. Thus, while activity for the full year fell short of MTSBP targets, most of it took place in the second half of 2009 and continued into the first half of 2010, where operational activity is close to the original projections.

Table 2a: Country by country breakdown – Actual outturns for 2007-2010 compared to Medium Term Strategy and Business Plan projections for 2007-2010[1]

SDR Million	BP BoD Approvals Target 2007-10	Actual BoD Approvals 2007-10	Difference	BP Signings Target 2007-10	Actual Signings 2007-10	Difference
Albania	23.2	54.6	31.4	19.7	41.8	22.1
Armenia	30.9	28.4	(2.5)	26.3	35.7	9.4
Azerbaijan	46.4	61.0	14.6	39.5	36.9	(2.6)
Bulgaria	92.8	47.7	(45.1)	79.0	63.8	(15.2)
Georgia	30.9	13.5	(17.4)	26.3	14.8	(11.5)
Greece	77.3	61.4	(15.9)	65.8	57.5	(8.3)
Moldova	23.2	33.3	10.1	19.7	18.2	(1.5)
Romania	100.5	88.7	(11.8)	85.5	43.2	(42.3)
Russia	116.0	307.0	191.0	98.7	262.2	163.5
Turkey	116.0	156.5	40.5	98.7	112.6	13.9
Ukraine	116.0	130.2	14.2	98.7	134.4	35.7
Totals	**773.2**	**982.3**	**209.1**	**657.9**	**821.3**	**163.4**

Note: A positive figure in difference columns means target was exceeded. A negative figure means target has not been met.
* For 2010, actual figures are as of end September.

[1] Actual country by country outturns compared to MTSBP 2007-2010 projections will be analyzed in detail in Country Strategies 2011-2014, including sectoral breakdown and evaluation of outturns and their impact.

As Table 2a shows, as of 30 September, 2010, the target amounts projected by the Bank's 2007-2010 MTSBP for BoD approvals have been exceeded by nearly SDR 210 million. For the same period, the target for new signings has been exceeded by over SDR 160 million. However, these numbers hide the fact that in some countries operations have exceeded targets by a wide margin, while in other countries the actual outturns in terms of BoD approvals and signings have fallen short of targets. Table 2b summarizes the breakdown of BoD approvals and signings by sector.

Table 2b: Sectoral breakdown – Actual outturns for 2007-2010

SDR Million	BoD Approvals	Signings
Agriculture, Forestry & Fishing	11.1	11.3
Retail Trade	5.4	1.9
Services & Real Estate	8.8	-
Financial Institutions	357.6	351.1
Energy	145.2	96.8
Manufacturing	176.0	151.9
Transport & Public Utilities	164.5	125.4
Telecommunications	51.8	67.9
Mining	24.7	-
Construction	37.3	14.9
Totals	**982.3**	**821.3**

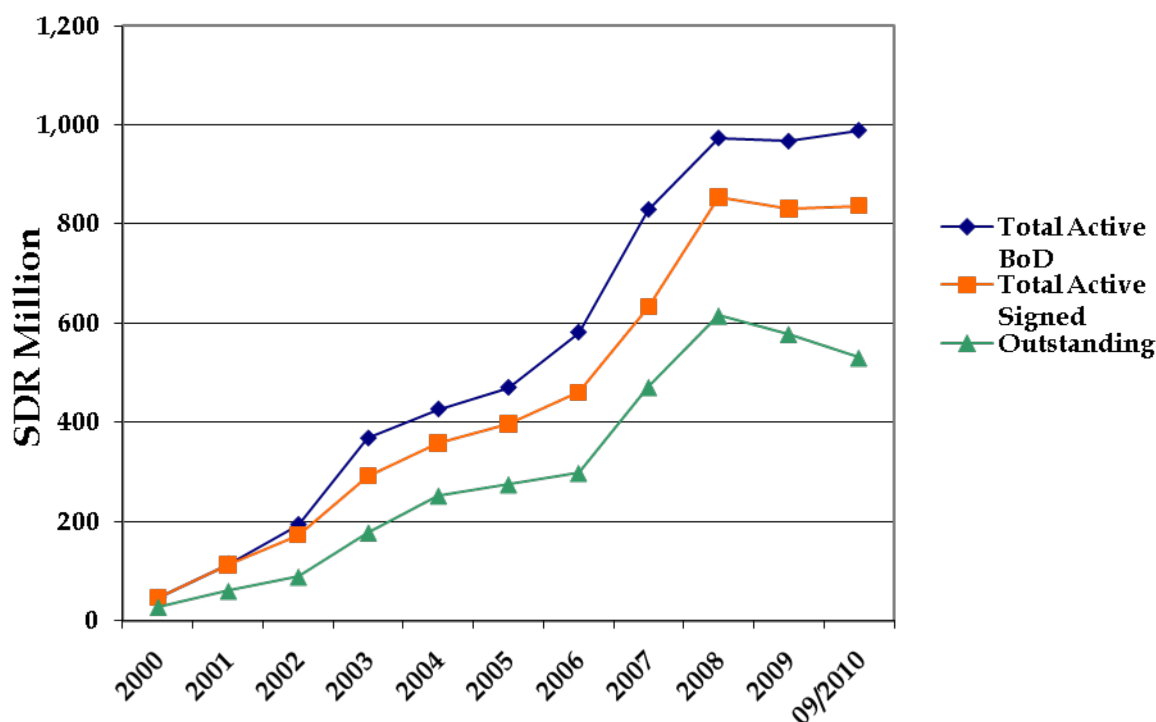
Table 3: Actual Year End Amounts Disbursed & Outstanding Versus 2007-2010 MTSBP Projections

SDR Million	2007	2008	2009	2010*
BP Annual Targets for Amount Disbursed & Outstanding at Year End	382.0	455.0	523.0	600.0
Actual Disbursed & Outstanding at Year End	474.0	618.0	578.9	530.9
Difference	**92.0**	**163.0**	**55.9**	**(69.1)**

Note: A positive figure in difference columns means target was exceeded. A negative figure means the target has not been met.
* For 2010, actual figures are as of end September.

In terms of the targets for the amounts disbursed and outstanding as at the end of each year, the MTSBP 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. As Table 3 shows, by end 2008, the Bank's disbursed and outstanding portfolio of operations stood at SDR 618 million, exceeding the four year target of the MTSBP. However, Table 3 also shows how the slowdown in new activity and the Bank's conservative approach to portfolio management has affected the overall portfolio size. The overall amount disbursed and outstanding shrank by approximately 5% during 2009 in line with planned levels, and has declined further in the first eight months of 2010. The target of SDR 600m is likely to be met by end 2010, unless there is a dramatic deterioration in economic conditions or additional exogenous shocks that freeze up credit markets again.

Figure 2: Evolution of BSTDB Active Portfolio 2000-2010

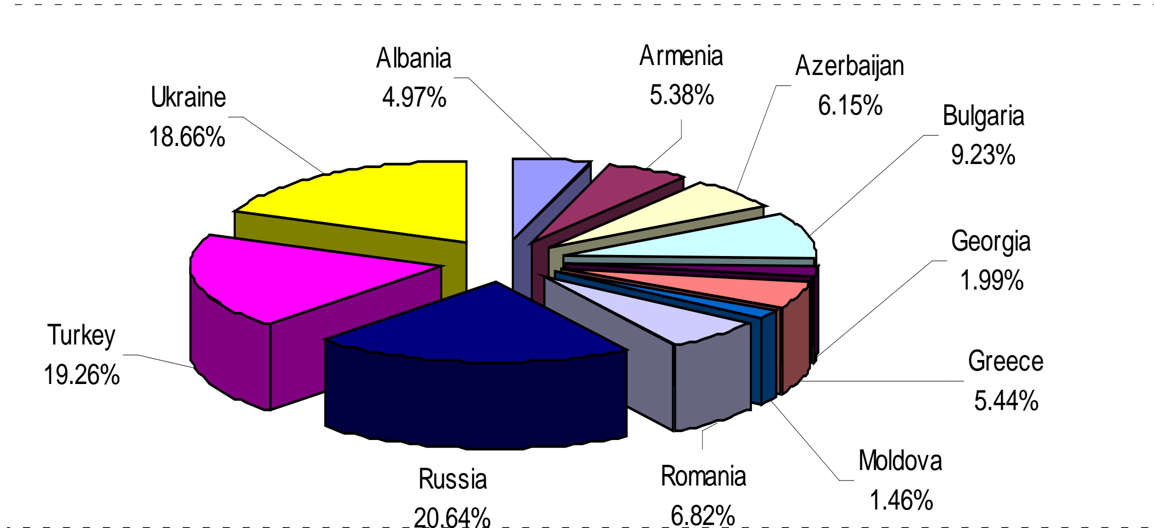


Note: Figures for BoD and Signed are not net of repayments.

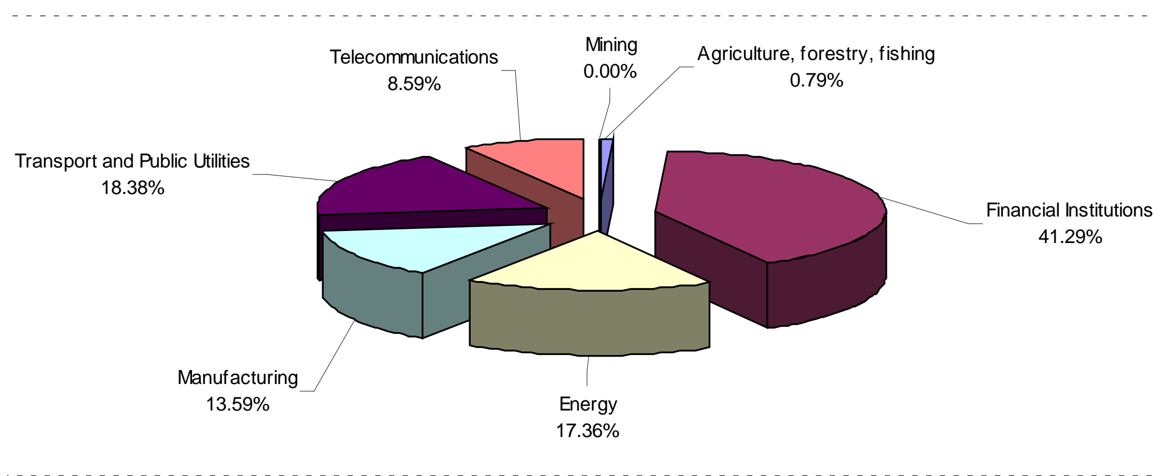
Brief Overview of the Current Active Portfolio(as at End-September 2010)

As at end-September 2010 there were 96 BoD approved operations for a total amount of SDR 989.9 million, of which 85 were signed for a total of SDR 837.6 million (not net of repayments). The amount outstanding stood at SDR 530.9 million. The annual evolution of BSTDB's active portfolio is given graphically in Figure 2 above. The value weighted maturity of the currently active portfolio at signing is 6.8 years – up from 4.9 years in 2006 – e.g. the end of the 2004-2006 MTSBP (this is separate from the average weighted maturity of the active portfolio which is approximately 3.2 years). The average size of signed operations in the active portfolio is approximately SDR 10.2 million (versus SDR 8.0 at end 2006). Operations approved by the BoD have a slightly larger average size of SDR 10.7 million (up from SDR 7.3 million at end 2006). This reflects the impact of the increase in the single obligor limit of the Bank from 5.0% to 7.5%. In larger countries, the average size of operations was SDR 12.3m, whereas in the five smallest shareholding countries average operations size was SDR 4.9m. The average margin earned by the Bank over its portfolio of outstanding operations is 3.91%.

Signings by Country



Signings by Sector



C3. Institutional Performance Evaluation

Overall, the Bank has demonstrated substantial development since its establishment and compares favorably with its peers in many respects. It has established both sound operating structure and portfolio and has a capacity to grow and fulfill its specific mandate. While still relatively small, the Bank has the potential to become a more prominent player.

During the last several years, BSTDB has made notable progress towards reaching the Business Plan target of 80% positively evaluated operations at the end of 2010. The latest sample of evaluated operations (2007-2009) indicates that this target is likely to be met in due course. The current performance of the evaluated operations is in line with that of peer IFIs.

While, until 2007, BSTDB was behind its peer IFIs (EBRD and IFC), in terms of the share of successfully rated operations, the difference was offset in 2007-2009 for the first time since 2000. The substantial increase in the share of well-performing operations from 34% in 2003 to 67% in 2009 came as a result of proactive measures (2006-2007) to analyze and mitigate certain practices, with a particular reference to:

- the "approval culture", prevailing until 2006, focusing on volumes of new operations with less effort on the quality and sustainability of existing portfolio;
- the related large wave of cancellations in the 2002-2004 period; and
- the initially (until 2006) low risk appetite of the Bank, resulting in slow growth of the portfolio.

The three issues above were analyzed in-depth by previous Annual Evaluation Overviews. While the recommendations of the analysis were implemented with success[1], the Bank should continue to address those three issues, in the context of the balanced scorecard under implementation, otherwise, their negative effects from the past may re-emerge.

The reported achievements of the Bank represent a solid basis for further development but should not be a source of complacency. To realize the Bank's vision of becoming a prominent IFI in the region, BSTDB intends to regularly and openly review its key strengths and weaknesses, to enhance the former and mitigate the latter.

Suggested improvements

To enhance further mandate fulfillment, the Bank also plans to:

- Put more emphasis on project finance;
- Implement balance scorecard incentives;
- Generate more cross-country operations;
- Further improve client relationships.

[1] In 2006-2007 the Bank undertook measures to improve its performance, including a number of strategy initiatives, and a new pricing policy, which contributed to the observed performance improvement for the 2007-2009 period.

Recent Financial Highlights

Table 4: Performance Evaluation

Indicator	2007	2008	2009	2010 estimate
RoA	1.90%	1.90%	1.26%	1. 39%
RoE	2.82%	3.88%	2.76%	2.34%
Net interest margin	2.7%	2.6%	3.2%	3.9%
Operational income /Operational staff (SDR)	766,412	878,521	656,233	953,913
Cost/Income Ratio (before provisions)	42.08%	39.74%	55.09%	44.44%
Cost/Income Ratio (after provisions)	63.98%	54.90%	53.44%	65.04%
Administrative expense/Total revenues	32.8%	24.7%	32.8%	44.4%

C4. Strengths, Opportunities and Challenges

Strengths

The Bank has a clear, stable, and enduring mandate that maintains relevance through time. The Bank draws its strengths from its status as a Development Finance Institution and the preferred creditor status attached to it. It possesses a governance structure in line with best practices, which guarantees operational autonomy backed by a system of checks and balances, and provides the framework for operational activity.

The Bank’s core competencies, its ability to deploy existing skills in order to generate superior performance, are:

- Strong and quick response time for due diligence from identification to BoD approval;
- Effective supervision and monitoring and evaluation;
- Ability to control costs;
- Strategic partnerships with other partners in development;
- Professionalism and dedication of its staff.
- Ability to bridge cultural gaps

Opportunities

Opportunities for BSTDB include the ongoing healthy demand for its services - primarily the provision of finance, but also the mitigation of specific risks (especially country risks), as well as networking and knowledge sharing benefits. This demand derives primarily from banks and private sector firms, rather than public sector agencies, and is a testament to the quick and flexible responsiveness of the institution to its potential clients.

An additional feature of considerable importance is that as an IFI, BSTDB potentially could play both a pro-cyclical and an anti-cyclical role relative to macroeconomic conditions and trends in private sector actors in capital markets. During the boom period, with demand for financing high but supply also ample, BSTDB was able to greatly expand its portfolio of operations and to provide financing to solid high potential firms. While margins were squeezed and blue chip firms showed declining interest in BSTDB services, this was more than made up for by an increased emphasis on smaller or more geographically isolated 'second tier' firms which possessed excellent potential for growth but due to market dysfunctionalities lacked full and affordable access to capital markets.

During the crisis period, demand for Bank financing rose significantly, as the freezing of capital markets and the heightened risk aversion of private financiers left IFIs as the most attractive and available potential source of financing. BSTDB's actual ability to deliver was limited by its own relatively restricted (relative to AAA rated IFIs) access to markets, but to the extent feasible, the Bank in 2010 sought to support regional banks and firms to the best of its ability.

Opportunities for more active Bank participation also exist in a number of underdeveloped non-banking activities, such as improving networking (into global markets) and increasing knowledge sharing for regional governments, agencies, banks and firms.

Challenges

Challenges are of both an internal (institutional weaknesses) and external (threats) nature. The Bank's capacity to take advantage of existing and emerging opportunities is restricted on one hand by its capital base and on the other by challenges it has to face.

Other challenges that the Bank faces and needs to address include:

- Increased volume of operations of EBRD, IFC and other IFIs in some Member Countries, at interest rates lower than what BSTDB may offer, mainly due to their lower cost of borrowed funds deriving from their high rating (AAA);
- The Bank's desired mix of credit quality, volume, and developmental impact in potential operations is not readily available in Member States at a time of economic stress;
- Relatively low capital base, lack of a AAA shareholder, and consequently a lower risk rating which impacts negatively on the volume and the cost of available funding.

Institutional Weaknesses

Despite improvements over the last few years, the Bank needs to remain diligent with respect to the length of time between BoD approval and signing, and signing and disbursement, as these are potential sources of inefficiency that can undermine effectiveness. Achievement of volumetric targets should also not overshadow performance indicators (e.g. commitments, disbursements, amounts outstanding, mandate fulfillment, profitability, asset quality, efficiency);

External Threats (market conditions, outside the control of the Bank)

a) ***Ability to borrow at acceptable terms and conditions*** in order to finance new operations is constrained by the following:

   (i) *Market sentiment* – this is reflected in the willingness of prospective lenders/investors to provide funding of required maturity and interest rate;

(ii) *Portfolio quality* – the Bank moves toward a larger volume of operations that may increase the risk of the portfolio;

(iii) *Risk rating of the Bank* – this depends mainly on the portfolio quality and strength of shareholder rating, and the Bank's ability to maintain positive net income results;

(iv) *Availability of sources of finance* – the availability of funding is sketchy and scarcity becomes a characteristic of the credit market, whether or not associated with risk aversion.

b) ***Market demand for Bank funding***:

(i) *Pricing of Bank operations* – as the Bank increases the volume of its operations there will emerge a need to increase borrowing. This will have two consequences: (i) as the ratio of borrowings to equity increases, the *marginal cost* at which the Bank may borrow will also increase, with negative impact on re-pricing rolled-over funds initially borrowed at lower rates; and (ii) as the ratio of borrowed funds to equity (assumed at zero cost) increases, the *average cost* of funds increases.

(ii) *Availability of bankable operations* – as the Bank increases volume of operations it has to identify increased numbers of potential operations that satisfy the risk appetite of the Bank. In addition the Bank may have to adjust its requirements, systems, procedures and organization in order to accommodate higher risks, if economic conditions continue to remain unfavorable, or even worsen.

II. STRATEGIC CONCEPT – Translating Strategic Objectives into Measurable Goals

Institutional Culture and Values

The Bank is committed to the development of an institutional culture characterized by transparency, disclosure of information, sound corporate governance, communication, cooperation for achievement of the Bank's strategic objectives, underpinned by a deep understanding and reflection of the Bank's mission.

The values that constitute the foundation of the Bank's institutional culture are moral integrity, professional competence, loyalty to the institution, commitment to the region, non-discrimination and respect for the opinion of others.

To this end, the institution is dedicated (and required) to attain appropriate levels of checks and balances that (i) ensure compliance with existing regulatory framework and (ii) enhance responsibility and accuracy without compromising efficiency and effectiveness.

Objectives

The principal objectives of the Business Plan are making steady and measurable progress in the following areas: (i) meet shareholder expectations and provide client satisfaction; (ii) maintain financial stability and improve operational effectiveness (asset quality, cost control, productivity, profitability); (iii) achieve institutional consolidation and process optimization; and (iv) establish and maintain a work environment conducive to attracting, motivating and retaining high quality staff with the required skills and attitude.

Goals

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

The Bank's main operational goal for the period 2010- 2014 is to increase its total outstanding exposure from about SDR 600 million to SDR 1.0 billion by end 2014, with a target Balance Sheet Size of approximately SDR 1.2 billion. The target of SDR 1.0 billion:

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

The public/private sector distribution goal is to increase the share of public and quasi-public sector operations to 25% in terms of the amounts of the outstanding portfolio, up from about 20% at present, with most of the increase coming via more infrastructure focused operations.

Equity operations should represent 5-7.5% of the value of the outstanding portfolio from 1.4% at present; the 5% figure is a minimum to be achieved under the low case or base case scenarios, while the upper 7.5% would be the target under the high case scenario.

The Bank's quality goal is to achieve an A2 risk rating from Moody's by 2014, as well as a comparable rating from a second leading credit rating agency.

Strategic Focus

The Bank sees its role as a provider of development assistance to public and private sector clients through several different channels:

- **Provision of Finance** – Funding for specific transactions on competitive terms, and delivered with minimum delays. This will be done through a variety of means including loans, guarantees, equity (demand for equity and quasi-equity investments is growing rapidly), special products, targeted programs and technical assistance. This includes public-private partnerships, an area where the Bank intends to increase its capacities.
- **Risk mitigation** – As a multilateral development institution owned by its client Member States, and thus benefiting from preferred creditor status, the Bank intends to play an important role in reducing the perceptions of risk about Member States individually and about the region as a whole. This may boost the attractiveness of the region and the confidence of external financiers. It would do so by:
  - First, by showing its own success as the result of regional cooperation.
  - Second, by mobilizing financial resources from outside the region at a cost lower than most of its Member States, and by making financing available to members assuming elements of country risk.
  - Third, by providing guarantees which reduce the risks faced by third party financiers, who will face the risk of BSTDB and not the risk of specific operations in particular Member States.
  - Fourth, by raising the level of recognition and the profile of regional organizations, firms and banks.
- **Catalytic Role** – the Bank will seek to promote opportunities for public-private partnerships in areas falling between traditional public and private domains. Furthermore, key secondary objectives of participation in operations are benefits such as (i) facilitating networking and development of new relationships among clients and partners, (ii) helping clients to modernize facilities, equipment and processes, to upgrade skills, and generally to achieve innovation, and (iii) enhancing knowledge sharing activities. In addition, through its resource mobilization efforts, the Bank will introduce new financiers to the region and seek to attract a multiple of the resources it directly applies, thus improving client access to financing. After financing operations with the Bank, these financiers would become familiar with the region and be able to establish direct relations with prospective clients.

Institutional Key Performance Indicators

To achieve its strategic objectives the Bank adopted 8 Institutional Key Performance Indicators (KPIs) that indicate the sense and direction of main activities, as well as serve as performance measurement framework, in the context of the Balanced Scorecard (BSC) that is being implemented. The 8 KPIs, (2 for each of the 4 BSC perspectives) are cascaded/translated towards respective Divisional and Departmental KPIs, across the entire Bank, in order to fully

address the Institutional KPIs, as well as the Institutional values. The cascading process involves the development of new sets of subordinated and supporting KPIs, which are not necessarily identical in nature/number with the Institutional KPIs, but are ultimately related/associated to the achievement of the Institutional KPIs. Hence, the Institutional KPIs are of a framework nature, rather than representing an exhaustive set of targets.

The institutional KPIs are grouped into the 4 BSC perspectives as follows:

Stakeholders and Clients Perspective

(i) Mandate fulfillment, with a 2014 target of at least 70% of post-evaluated operations to rate positive on fulfillment of the dual mandate of development and regional cooperation.

(ii) Core mandate-related targets upon operation generation, aimed for the life of each operation, aggregated for the portfolio generated within the period 2011-2014:

   a) direct/indirect employment provided per one million SDR invested by BSTDB via the project finance operations to present an upward trend from the baseline in 2010, and to compare positively with the IFI harmonized measure;

   b) government revenues from financed operations: 5% of BSTDB investment.

Financial Perspective

(i) Good asset quality: will seek to contain non-performing assets to less than 3% of the total portfolio.

(ii) Financial Returns on Assets: 1.3%.

Internal Processes Perspective

(i) An increasing share of Concept Cleared Operations to become BoD approved, with a targeted improvement of 10%.

(ii) An increasing number of BoD approved operations to disburse at least 50% of the committed amount with a targeted improvement of 5%.

Learning and Growth Perspective

(i) International recognition for contributing to IFI's good practice: at least five staff members per annum to obtain documented/published acknowledgement by peer professionals/IFIs.

(ii) BSTDB contribution to IFI international professional events: 10 peer meetings with IFIs per annum.

Key Risk Indicators

The Bank decided to establish a monitoring system in relation to the management of operational risks. One of the main processes for such management includes the development of Key Risk Indicators (KRIs), where appropriate, to act as early warnings of increased risk of potential losses. Effective tracking of these indicators shall allow the Bank to identify changing risks upon their occurrence and respond to them promptly.

The KRIs complement the KPIs in contributing to an organization's growth and success and relate to the key business objectives too. These KRIs can be both of a qualitative and quantitative nature. On the basis of the BIS paper 'International Convergence of Capital Measurement and Capital Standards' (Basel II) document, Annex 7, the Management will adopt in due course specific KRIs and their correspondent thresholds, reflecting the 4 BSC perspectives.

Benchmarked Performance Indicators

In addition to the above KPIs, the Bank has established a set of institutional performance indicators, benchmarked against a selected peer group of high profile Development Finance Institutions (DFI), against which to asses its performance. All DFIs selected are internationally reputed well established institutions with a long track record of development assistance. They all benefit from a AAA risk rating (see Table 5).

With the exception of the Council of Europe Development Bank, which is specialized in social development, all other DFIs in the group focus their activities on financing operations in the private sector, or are conducive to private sector development. All DFIs selected in the peer group are active in the Black Sea region.

Table 5: Performance Indicators – 2008

Indicator/DFI	BSTDB	EBRD	IFC***	NIB	CoEDB*	FMO	DEG	Proparco
Number of Total Staff	98	1,407	2.290	170	146	256	353	102
Number of Operational Staff **	27	686	1.302	59	-	113	181	48
Total Administrative Expense (USD m)	17.3	340.2	536.6	42.4	42.0	77.9	98.4	24.9
Committed Number of Projects	30	302	372	53	39	197	112	67
Total Number of Portfolio Companies or Projects	90	1,416	1,839	-	Est. 193	873	452	300
Operational Staff/Total Staff	27%	49%	57%	35%	-	44%	51%	47%
Total Administrative Expense/ Total Staff (USD m)	0.18	0.24	0.23	0.31	0.29	0.30	0.28	0.24
Committed Number of Projects/ Operational Staff	1.11	0.44	0.29	0.9	-	1.74	0.62	1.40
Committed Number of Projects/ Total Staff	0.3	0.2	0.16	0.3	0.27	0.8	0.3	0.7
Commitment Volume/ Operational Staff (USD m)	17.01	10.46	8.79	64.25	n.a.	16.08	9.36	22.95
Commitment Volume/ Total Staff (USD m)	4.7	5.1	5.0	22.3	17.8	7.1	4.8	10.8
Commitment Volume/Total Administrative Expense	25.8	20.9	21.2	89.3	62.0	23.5	17.3	44.2
Total Equity (USD m)	540	15,540	18,261	2,407	2,500	1,721	1,943	711
Return on Assets (RoA)	1.90%	-1.12%	0%**	-1.24%	0.45%	1.00%	0.53%	1.3%

Source: EDFI, DFI Annual Reports

* CoEDB (most operations are in the public and quasi-public sector), BSTDB and NIB refer to all operations; EBRD, IFC, FMO, DEG and Proparco refer to private sector operations only.

**Includes bankers, support staff, analysts (excludes credit risk, environment, economic, procurement, legal, portfolio management) working in private sector operations

*** Fiscal year 2008 for IFC ends in June and has a ROAA= 3.97%. However, Q1 and Q2 fiscal year 2009, the third and fourth quarters of calendar year 2008, show both negative income, bringing thus the net income for the calendar year 2008 to negative values. Both operating and net results for fiscal year 2009, ending in June 2009, were negative. Administrative expenses increased by 21% on an annualized basis. IFC does not use IFRS for financial reporting (uses US GAAP), it is expected to complete the transition in 2009.

Table 6: Medium term Target Performance for BSTDB at end of 2014:

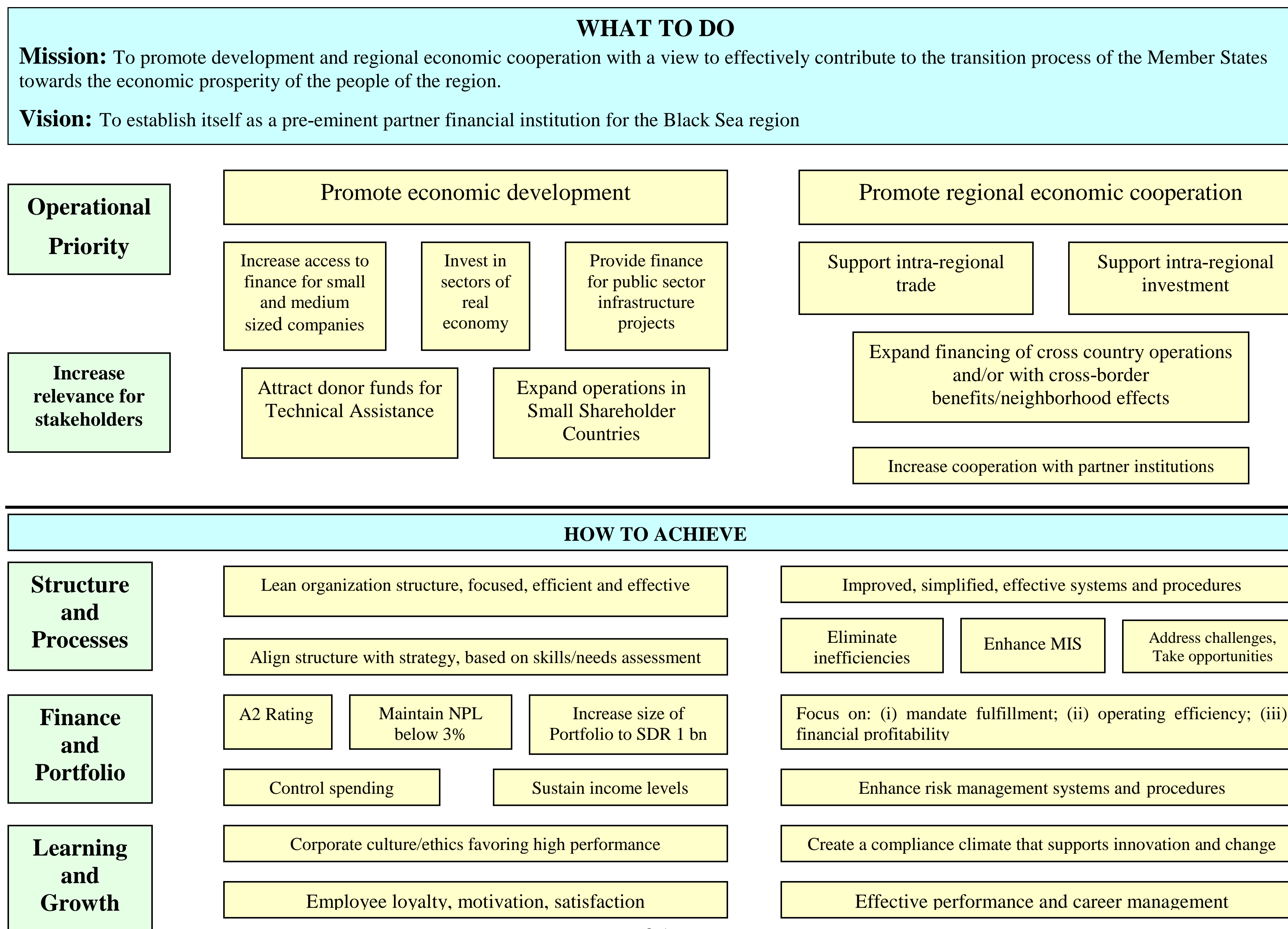
Number of Total Staff	110	**Direct Operational Staff /Total staff**	35.5%
Number of Operational Staff *	30	**Total Administrative Expense/ Total Staff** (USD m)	0.21
Number of Direct Operational Staff**	39	**Committed *** Number of Projects/ Operational Staff**	1
Total Administrative Expense (USD m)	23.5	**Committed *** Number of Projects / Total Staff**	0.27
Committed* Number of Projects in Year**	30	**Commitment*** Volume/ Total Staff** (USD m)	4.36
Total Number of Portfolio Projects	170	**Commitment*** Volume/Total Administrative Expense** (USD m)	20.4
Average Operation Size (USD m)	16	**Total Equity** (mil USD)	960
Annual Commitment* Volume** (USD m)	480	**Return on Assets** (RoA)	1.3%
Operational Staff/Total Staff	27.3%	**Return on Equity** (RoE)	2.4%

* Bankers, Analysts, Administrative assistants in Banking and FAD (EDFI standard definition)

** Bankers, Financial Analysts, Credit Risk, Environment, Economic, Procurement, Legal, Portfolio Management, excluding Administrative Assistants supporting these functions

*** Committed here means BoD approved operations

FIGURE 3: BSTDB STRATEGY MAP



III. BUSINESS STRATEGY

A. OPERATIONAL STRATEGY

A1. Action Plan

In order to address challenges, and with a view to achieving goals and targets set in this document, the Bank will implement an Action Plan. The Action Plan will be reviewed and updated in the context of the mid-term review of the Medium-term Strategy and Business Plan. If necessary, due to new shocks or rapidly changing regional conditions, additional modifications and/or updates may be considered, as required.

The main features of the Action Plan of the Bank are the following:

a) For the Board of Governors to authorize the Management of BSTDB to intensify contacts with IFIs which have the potential and show an interest in becoming shareholders in the Bank and to carry out substantive discussions to this end. To facilitate this process the BoG will set an indicative amount of the shareholding such IFIs can be offered for subscription (individually per IFI, and collectively), and will determine conditions of their admission.

b) To prepare conditions for expanding operations in the priority areas, through effective promotional and business generation activities, and enhanced due diligence and monitoring activities. This will require continuous evaluation of the effectiveness and efficiency of the staffing processes and a proactive approach in assessing and planning the quantity and quality of the skills required to implement the Bank's strategy.

c) To expand efforts to establish, catalyze and extract benefits out of synergies and closer cooperation with other international organizations, Export Credit Agencies and development agencies, in particular those which have Observer Status with the Bank, in order to increase mobilization of foreign financial resources to the region, and enhance provision of multilateral assistance through multi-purpose development programs. In this respect, increasing the amount of co-financing with development partners (e.g. Observers) will represent a key criterion, as will efforts to expand technical assistance activities.

d) To seek additional activities which promote the region and fulfill the Bank's mandate, including but not limited to, activities such as networking opportunities, knowledge sharing, and promotional events and/or partnerships which highlight the attractiveness of the region.

e) To increase the options and resources for the Treasury to take advantage of funding opportunities and invest in capital markets, so as to be able to access markets and optimize liquidity management. This would allow better planning and execution of the borrowing program at the best available terms and conditions, and will require a shift in focus to targeting Balance Sheet size in addition to targeting outstanding portfolio size.

f) To create an environment conducive to attracting, motivating and retaining high quality staff. Staff motivation and job satisfaction are considered essential contributors to the achievement of the Bank's objectives. To this effect the Bank will continue to review,

develop, and amend where necessary, the Human Resources policies, in the context of the Balanced Scorecard.

g) To increase integration and real-time multi-level use of Management Information System (MIS) and upgrade its availability and capabilities, with support from appropriate IT solutions.

h) To control administrative expenditures in a prudent manner according to the needs and priorities of the institution.

i) Further enhance the Enterprise Risk Management.

j) Adoption in 2011 of a new functional and reporting effective currency, in conformity with the recommendations, and concurrence of the Independent External Auditors. With the support of the BoD and BoG, the Management will take all necessary steps to ensure a smooth transition, preparation and presentation of financial statements for 2011 in the newly selected currency.

A2. Areas of Intervention

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

(i) Marketing and Business Generation

The Banking Division will remain the core "production" center of the Bank, where most of the revenues are generated through preparation and implementation of corporate/project and trade finance operations. Emphasis will be given to building a pipeline of operations consistent with country/ regional needs and institutional objectives and to strengthening the capacity to respond to emerging opportunities.

Promotional activities will be carried out to increase the Bank's market presence and strengthen its role in satisfying its specific niche. Such activities will be supported by the following communications activities:

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

(ii) Mobilization of Financial Resources

Sources of funds

As the Bank grows larger it will become increasingly dependent on the bond markets as its main source of funding. An alternative funding source will remain bi-lateral or syndicated borrowing – but given the weakened state of commercial banks' balance sheets, they are likely to provide only limited amounts. BSTDB will also continue to seek some funding from other IFIs or government agencies.

Investor development

The Bank will need to introduce itself to a wider range of international investors. Targeted investor groups might include Emerging Market Funds, Sovereign wealth funds, General Funds, Central Banks, Development banks, and Commercial Banks. Geographically the USA, Middle East and Far East may compensate for the shortage of investors in Europe. Member States should also be targeted where possible.

Strategy

- The Bank will seek to obtain a second rating from a leading credit rating agency as soon as possible.
- Lead arrangers for next bond issue will be identified in Q4 2010.
- Bond issues will be supported by high profile road-shows.

Given the uncertain market conditions the Bank should seize issuance opportunities when available.

1. Given loan portfolio growth from SDR 597 million at the end of 2010 to SDR 1 billion at the end of 2014, the following borrowing activity is projected.

a). 2010 - SDR 112 million – from a range of bilateral borrowings.

b). 2011 – Funding required will be impacted by capital receipts (SDR 47.5 million due by 31st December 2010, SDR 25 million due 2011). New funds will be required to fund maturing liabilities and new business for second half of 2011 and to pre-fund new business and maturing liabilities in the first half of 2012. Based on current projections net funding requirements to fund 2011 and 2012 will be between SDR 250 and 350 million. It will not be advisable to delay this funding beyond the end of 2011.

Given the size of the funding requirement a bond issue appears the preferred option. There are two windows of opportunity April – May 2011 or October – November 2011 (the period between availability of audited financial statements and 145 days after the date of the audited financial statements). April – May 2012 is a more cost effective possibility – but only as an absolute last resort. The Bank should make all necessary preparations (additional rating, appoint lead arrangers, prepare documentation, meet investors etc) as early as possible – in order to allow

for maximum flexibility and should be prepared to consider moving early (and bearing the carrying costs) if conditions look favorable in the second quarter of 2011.

Market conditions for issuance are constantly changing, however based on current investor preferences the following issue terms look most likely to succeed:

- A RegS (issuance registration/disclosure requirements for the world outside of the USA) /144A (requirements for the USA) issue targeted at European and US investors
- A benchmark issue size (USD 500 million)
- A maturity of 5 years
- Denominated in US Dollars

c). 2012 – The funding requirement for the year should mostly be covered by a successful bond issuance in 2011. If smaller sums are required bi-lateral lines will be sought.

d). 2013 - 2014 – Funding required is projected in the range of SDR 80 – 120 million for each of these years. This requirement may be met either from the syndicated / bilateral loan markets or from further bond issuance – subject to market conditions.

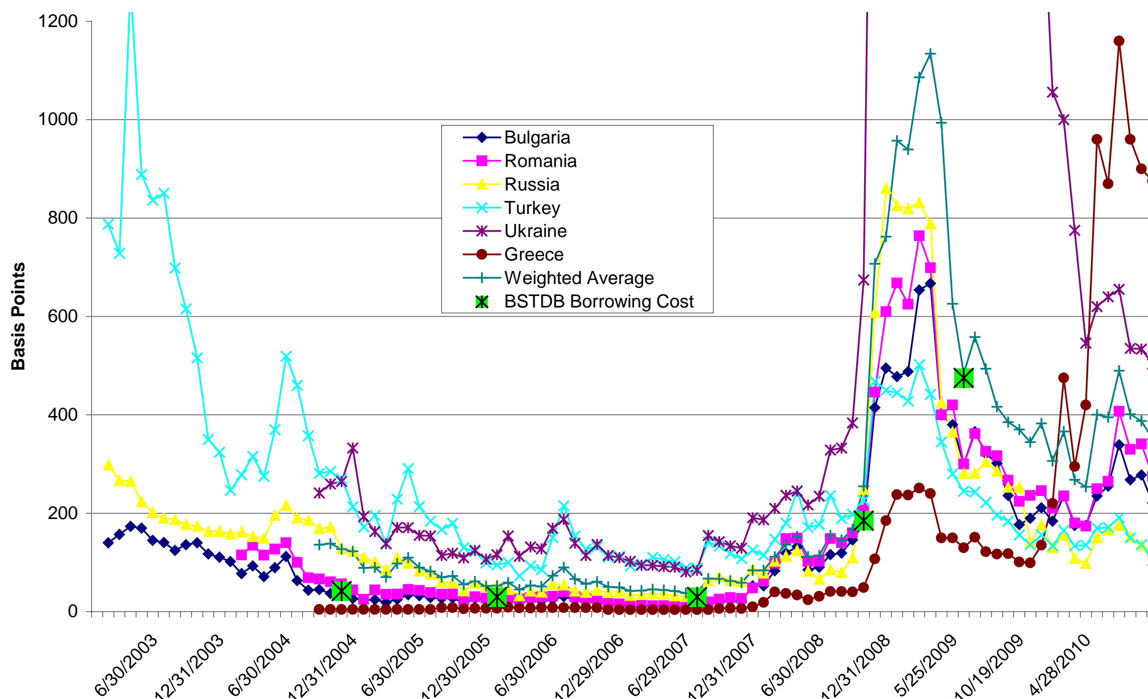
5 year maturities now available – removing refinancing requirement from 2014, larger issuance size preference from investors (one big issue rather than two small).

2. Impact of recent rating upgrade and tightening of Member State CDS levels on borrowing costs.

    - The Moody's upgrade to A3 has been most helpful in clearly separating the BSTDB from the Members. This should translate into cheaper borrowing by 10-15 basis points.

    - A second rating, in the A range, would significantly improve the Banks borrowing cost. However, even a BBB+ second rating should provide additional comfort to bond investors.

    - Recent tightening of credit spreads in the six largest BSTDB Member States will contribute to a reduction in potential borrowing costs. The Credit Default Swap levels provide a good indication of this trend. (See attached table). Despite continuing problems in the region, the 3 year average CDS (a good indicator of BSTDB funding costs) is down to 350 bps. Based on the rating upgrade and currently improved credit market conditions there are grounds for tightening expectations by 25 basis points for each year.



(iii) Control of Expenditure

Effective control of expenses would remain a priority area of attention of the Bank. It would involve good planning, budgeting and accountability at institutional, divisional and departmental level.

Operating expenses

Cost control would assess the structure and nature of operating costs, their minimum possible amount and the pricing margin that ensures operating cost coverage. Operating expenses may be reduced by:

- Maintaining a high quality portfolio, with an optimal maturity structure.
- Continuous demonstrated support from Member States (shareholders and beneficiaries).
- Concerted effort to upgrade further the credit rating. A rating at the equivalent of AA - assuming a new AAA rated shareholder, Members support and high quality portfolio - would reduce the cost of borrowed funds to a level approximately equal to Libor/Euribor.

(iv) Information Technology and MIS

The Bank's IT action plan for 2011-2014 will be closely aligned with the strategic objectives as stated in BSTDB's long term strategic goals and translated in the MTSBP. To better meet and serve these objectives, but also for the Bank to achieve them, the IT strategy will concentrate on maintaining: operations excellence through efficient and effective support of the IT infrastructure; creating and supporting business unit partnerships through development of effective decision support systems; providing strategic support by driving business unit success with innovative IT Solutions). More specifically, the IT action plan would seek to:

- expand and enhance the virtualization project, including the virtualization to all desktops of the organization and capitalize when possible on the cloud computing technology to better administer the IT services;
- continue to build on the business application development to better capture the BSTDB business processes in the following areas: financial operations, banking operations, performance management, budgeting, HR capital management, including a more comprehensive reporting system;
- improve management and control of the quantity of information used within BSTDB, an Enterprise Content Management system will be built, which will better unite, people, processes, and content to improve BSTDB's efficiency, innovation, and compliance by empowering people, automating processes, and controlling the risk and cost of content;
- enhance the communication capabilities of BSTDB by installing a video and audio conference facility;
- improve further the Website content and functionality including interactive features such as forums, blogs, collaboration and personalization;
- manage better IT risks by adopting IT industry standards and best practices such as COBIT, ITIL, SOX, ISO 27000, etc.

(v) Effective Human Resource Management

The human resources management reform activities planned for 2011-2014 would aim to (i) attract and retain the right people, in the right job, with the right motivation, skills and training; and (ii) create an enabling work environment for staff to achieve their objectives.

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

The major components of the human resources program would be:

(i) HR policies, procedures, processes and systems in support of the MTSBP such as:

- Employment relations (Recruitment, Placement, Retention & Succession, Redundancy and Separation from Service/ & Termination; Personnel Administration), with the most critical elements being: Job Design and Job Classification, Human Resources Planning/Workforce Planning;
- Compensation and Benefits (Remuneration and Salary Scale);
- Career Management (Staff Development, Learning/Development/Training, Career Path, Staff Mobility; Performance Management, Promotion);

(ii) Talent Sourcing which refers to attracting and retaining talented people committed to the values of the organization;

(iii) Staff Capacity which refers to developing the capacity of staff members to reach their full potential, and assessing the capacity needs (in terms of number of staff and qualifications) and making the necessary investments; and

(iv) Enabling Environment which is about creating a positive and enabling working environment that motivates staff.

(vi) Enterprise Risk Management(ERM) - Integrating the Management of Performance, Risks and Controls

The Bank will focus on the following four areas:

a. IT Governance

Where possible and financially feasible, emphasis would be placed on automated controls. During the transition towards an integrated banking system that supports increased operational volumes and automation, management and staff at all levels will be appropriately guided and trained, and appropriate policies and procedures will be introduced and refined in order to enable proper utilization and facilitation of an efficient and effective system of internal controls.

b. Consolidating and Linking KPIs and KRIs to Risks and Controls

Active assessment of the “predictive-ability” in relation to risks and controls of each KPI/ KRI is an ongoing facet of the ERM process. Therefore, as soon as the Bank’s Balanced Score-Card is implemented, the ERM process would also be enhanced to consolidate and link KPIs and KRIs to risks and controls, as appropriate and following best practices.

c. Incorporating ERM in strategy setting

An ERM approach to risk management integrates management’s processes. ERM links the Bank’s key risk exposures and strategic objectives, in order to strengthen the value proposition for risk management and risk oversight by identifying where risks are overlapping within an individual strategy and where certain risks may affect multiple strategies. This dimension of ERM will be pursued in cooperation with the Policy and Strategy function, starting in 2011.

d. Further Enhance and Define the roles of ERM participants

Key participants in the Bank's ERM process include (i) the Board of Directors and Audit Committee, (ii) the Management Committee and permanent ERM Working Group and (iii) the Internal Audit Department and External Auditors.

Going forward: (i) the Audit Committee's Terms of Reference would be reviewed; (ii) the ERM Working Group Terms of Reference would be established; (iii) adequate resources would be budgeted as appropriate; and (iv) the required services on ERM would be included in a possible international tender for the selection of External Auditors.

B. INSTITUTIONAL OBJECTIVES

As stated in the Long-term Strategy, the Bank has embarked on an ambitious development agenda to enhance quality and strengthen the focus on development results in its operations. Over the next four years efforts will be made to achieve progress in the following key areas:

(i) improve quality at entry in operations by strengthening the due diligence process;

(ii) enhance the monitoring, risk management, control and evaluation systems through further IFI harmonization and peer reviews (best practice) in operations, in order to attain higher impact while controlling the risk-return profile of operations;

(iii) increase profitability, as measured in three areas:

   a. net revenues after operating expenses to net revenues before operating expenses;
   b. operating income to operational staff;
   c. cost/income ratio

(iv) increase productivity, as measured in two ways:

   a. number of operations per banker/ staff;
   b. amount per banking team/ staff.

(v) improve systems and procedures for results reporting.

C. OPERATIONAL OBJECTIVES

The Bank will target mobilization of domestic and foreign resources into the region. As a consequence of the global financial crisis there is currently throughout the region huge demand for, and lack of supply of, medium term financing, and with very limited availability of alternative financing solutions. In this context, cooperation with other international financial institutions will continue to play a significant role, in particular for larger sized operations.

The Bank will face the following challenging tasks:

- To focus on its development function without compromising profitability, liquidity and capital adequacy;
- To adopt an individual and focused business approach in each country of operations while avoiding over-stretching the institution's administrative and financial capacities;

- To channel additional external financing into the region in the current operating context of high country risk and perceived economic vulnerability.

The Bank will target a well balanced portfolio composition between (i) sectors of economic activity and (ii) among Member States, while applying sound banking principles.

Along with continuation of the Bank's cooperation with large and well established corporates, more emphasis will be placed on establishing business contacts with medium-sized companies and so-called 'second tier' firms - companies with high potential, but either new to the market, small in size, geographically remote, or with capacity constraints in their business operations (not to their core business model but due to specific administrative matters). Helping such firms through provision of financing and risk mitigation will be enhanced by additional benefits such as improved networking and knowledge sharing, modernization of equipment and processes, and promotion of innovation.

C1. Products

The Bank's objective is to provide financing solutions by offering, combined or on a stand alone basis, the products approved by the BoD, and by developing new products when the need arises.

Products offered by the Bank may include separately or in any combination debt, equity and guarantee structures. The majority of Bank operations will continue to be debt products, but equity is expected to increase to about 5-7.5% of total exposure.

The Bank will be open to employing more equity and thus increasing the share of equity financing as a share of its outstanding portfolio, since in the given environment demand for equity will likely continue to be high, and BSTDB equity provision is likely to have a greater impact in helping clients to mobilize additional resources in the market. This is especially true as the expected tightening of global Banking rules will require higher levels of capital to be held by banks (e.g. lower availability of, and costlier, lending). Thus provision of higher levels of equity to Bank clients will facilitate their access to affordable financing. In practice, this means for the most part (i) the strategic use of equity in small firms strategically in order to improve their access to capital markets resources, and (ii) the judicious use of investing through specialized investment funds.

A special area of attention will be public-private partnerships (PPPs), which may represent useful tools in order to support sovereigns and quasi-sovereigns to expand or improve infrastructure, and an area in which the Bank will seek to improve its capacity.

Guarantees, including through unfunded risk participation, will be used to support mobilization of financial resources by firms.

The Bank will also seek to improve its technical assistance services, which will include the use and expansion (to the extent feasible) of Special Funds, and it will explore opportunities to provide mandate promoting value added services to its range of clients.

C2. Risk

The Bank's risk appetite is limited by the capacity of its clients to compensate the Bank for the credit risk assumed in financed operations. For the 2011-14 period, macroeconomic/ country risks will likely be more significant, and these are risks which the Bank by its nature is bound to assume. If these are added to increased market risks, in particular exchange rate and interest rate

risks, this means that the overall risk the Bank will face in the future may be expected to increase. Therefore, the Bank will need to enhance its risk assessment and risk management capabilities appropriately.

C3. Pricing

The pricing of Bank financed operations shall incorporate the requirement that revenues cover related costs and help the Bank to accumulate adequate reserves and surpluses. The average interest rate margin calculated over the entire portfolio of outstanding operations should be sufficient to absorb expected losses, and to cover the overhead expenses and the blended average cost of employed capital (including shareholder contributed and borrowed funds).

The above requirement should apply in aggregate (across the entire portfolio); each operation shall be reviewed individually and the margins, fees and commissions shall reflect the specific conditions of that operation. Furthermore, the Bank may decide, as appropriate, to cross-subsidize specific operations within its portfolio in order to maximize development impact.

C4. Sectoral Priorities

Over the new Medium-term Strategy and Business Plan period the Bank shall seek to:

- Promote further sectoral diversification: manufacturing, energy, transportation, telecommunications and IT;
- Increase exposure to infrastructure, quasi-sovereign, and sovereign backed projects;
- Pay more attention to operations with equity and quasi-equity;
- Expand SME coverage using credit lines and guarantees to banks and leasing companies, and through participation in dedicated equity funds;
- Increase emphasis on medium sized companies and second-tier high potential firms.

The specific priorities would differ by country, and will be specified in further detail in the forthcoming country strategies.

C5. Operational Targets

The average final maturity of the operations in the Bank's portfolio is projected at about 6 years. The Bank forecasts indicative targets of its total available ordinary capital resources over the period 2011-2014 broadly along the lines enumerated below.

Intermediated Operations (in all countries)

Intermediated operations are planned to amount to approximately between 35% and 40% of the total portfolio and will include operations such as financial sector intermediation for trade finance and SMEs operations, and specific and general purpose financial sector operations;

The envisaged sectoral exposure limit is tentatively established as follows:

- Up to 65% of the intermediated operations for SMEs, including credit lines, guarantees and leasing operations;
- Up to 30% of the intermediated operations would be Trade Finance related products;

- Up to 15% of the intermediated operations would be financial sector activities, including bank-to-bank loans and mortgage facilities.

Cross- country operations

Cross country operations or operations where benefits directly accrue to more than one country are expected to reach approximately 10% of the total portfolio. These operations will spur innovation and induce modernization in energy (in particular renewable or environmentally friendly) and other infrastructure, e.g. transportation, telecommunication, waste water and/or solid waste treatment.

Direct Operations

Direct operations are targeted to amount to approximately 50-55% of the total portfolio with a focus on (i) large and medium sized corporations, which either are market leaders or have rapid growth and enjoy good economic prospect, able to provide a constant flow of income, (ii) other viable private sector companies which suffer temporarily from either lack of availability or excessive interest cost of funding, and (iii) entities in the public sector which need funding for operations with development impact.

By sector, direct operations are indicatively set at:

- Up to 30% of direct operations for transportation;
- Up to 25% of direct operations for manufacturing;
- Up to 35% for direct operations in energy
- Up to 20% of direct operations for other sectors- telecommunications, mining, construction, agriculture, services, etc.

Country strategies will provide further detail of target amounts and operational objectives in each shareholder country, for intermediated and for direct operations. Detailed targets for front-office and supporting departments shall be defined through work programs in annual budget documents, according to specific responsibilities, and taking into account productivity and efficiency considerations.

Breakdown of Operational Targets, by Type of Operation and Sector, 2010 & 2014

	Share in 2010 (End Sept.)	Targeted Share in 2014
Intermediated Operations	**36.2%**	**35-40%**
Of Which:		
SMEs	67.7%	55-65%
Trade Finance	25.1%	25-30%
Other Financial	7.2%	10-15%
Sub-Total	*100.0%*	-
Cross Country	**N/A**	**10.0%**
Direct Operations	**63.8%**	**50-55%**
Of Which:		
Transportation	26.8%	25-30%
Manufacturing	22.3%	20-25%
Energy	29.9%	25-35%
Other	21.0%	10-20%
Sub-Total	*100.0%*	-
TOTAL	**100.0%**	**-**

D. FINANCIAL STRATEGY

D1. Financial Plan

The Bank's financial plan is developed on the basis of the Operational Strategy and Objectives with due attention paid to the constrains imposed by external and internal factors. The Base Case Scenario allows the Bank to conduct operations in a still difficult environment marked by uncertainties and to achieve at the end of 2014 a size of its outstanding portfolio of operations of SDR 1 billion, with a balance sheet size of SDR 1.2 billion.

D2. Base Case Scenario

The assumptions under which the Base Case Scenario (BCS) was developed are the following:

- The outstanding portfolio will reach SDR 1.0 billion, and the Balance Sheet size would amount to about SDR 1.2 billion at end 2014.
- The average annual growth rate of the outstanding portfolio is 13.7%.
- The amount of newly signed operations per front office staff per year is SDR 13 million.
- Average loan maturity of an operation at the time of signing is 6 years (2 years availability and grace period, 4 years of repayment in equal installments).
- For the Black Sea region, a weak economic recovery is projected of 2-3% per annum eventually reaching 4%, despite risks of weakening growth in the European Union. Financial markets are expected to stay risk averse and tight, but will gradually improve.
- Member States pay their contribution to the capital increase in full and on time.

- The accession of new member(s) as shareholders from among AAA rated development finance institutions is finalized by 2014, with a cumulative stake up to 12%.
- The net change in staff numbers up to 2014 relative to the current figures budgeted for 2010 is an increase of 10-17 professional staff, mainly in front office and credit appraisal positions.
- The Risk margin declines from 1.85% in 2010 to 1.25% in 2014 due to anticipated risk rating upgrades of Member Countries and the good quality of the Bank's portfolio.
- Cost of borrowed funds declines over time as a result of the improvement in the Bank's risk rating to A2 (from Moody's). An additional upgrade to A1 is feasible if an AAA rated shareholder joins by 2014. The Bank would also seek a second rating from a leading credit rating agency in order to improve further access to capital markets.
- The Bank will sign every year new operations ranging between SDR 200 and 260 million. By 2014 between 5-7.5% of disbursements will be equity investments.
- To finance the growth in operations the Bank will need to issue a bond most likely in the second half of 2011 in order to finance operations in 2012, repay maturing debt obligations and provide a basis for expanding operational activity in 2013-2014, after having only marginally increased the stock of borrowed funds in 2011. If this does not prove possible, it may still be feasible to achieve the growth in outstanding by offering guarantees for mobilization of external financing.
- The Treasury will continue to generate revenues but banking operations will remain the principal profit center in relative terms. The main concern of the Treasury will be to secure the funds necessary for Banking operations. In case of funds remaining underutilized, the Treasury would seek profitable investments.
- Net income will increase from SDR 10 million in 2011 to SDR 15 million in 2014.
- Provisions are assumed to reflect the relationship between the Risk Margin and the portfolio quality, and are set to decline from 6.25% in 2010 to 5.8% in 2014. As a matter of good practice in the current environment of uncertainty, the Bank will seek to build general provisions at the level of the single obligor limit. Additions to provisions will be made from annual charges over the incremental portfolio of outstanding operations. Specific provisions for impairment of particular assets shall normally be constituted from annual income. There are no actual write-offs and recoveries forecast for the period covered by the Business Plan.

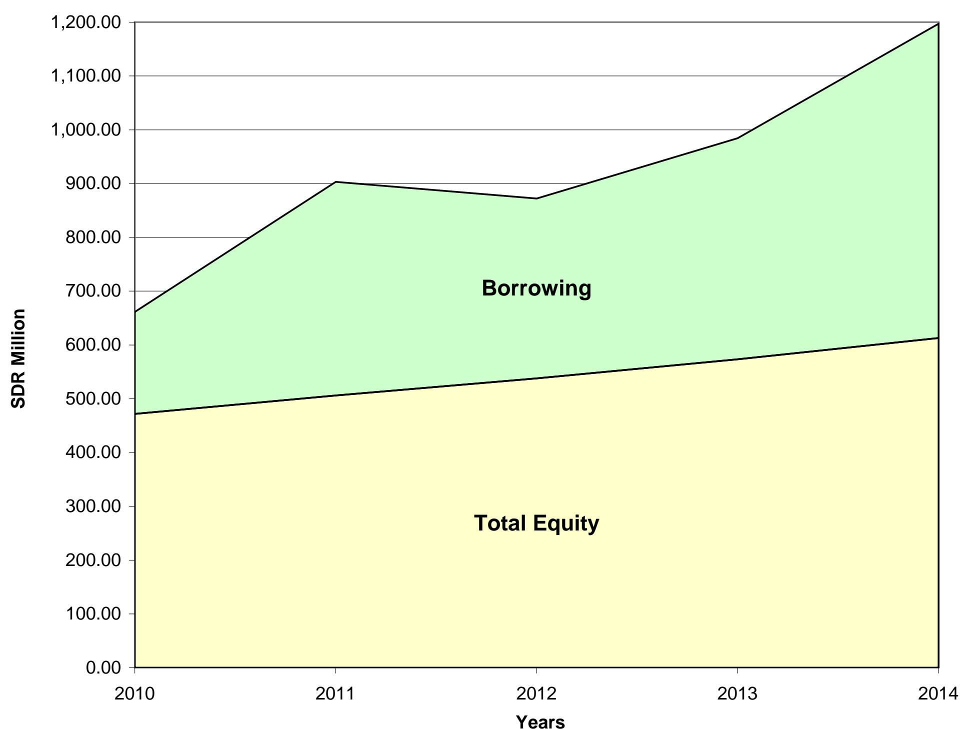
Table 7: Main Indicators Base Case Scenario

INDICATORS SDR mil.	**2010**	**2011**	**2012**	**2013**	**2014**
Operating Assumptions					
Avg. Staff	98	106	109	110	110
Avg. Loan maturity	6.00	6.00	6.00	6.00	6.00
Amount per operation	10.00	10.00	10.00	10.00	10.00
Financial Assumptions					
Base Rate (return on liquid assets)	1.39%	1.08%	1.19%	1.61%	2.12%
Cost of Borrowed Funds (Above Base Rate)	2.90%	3.25%	3.25%	3.00%	2.50%
Average cost of funds	0.83%	1.43%	1.25%	1.25%	1.22%
Interest on loans	5.26%	5.26%	5.19%	5.36%	5.59%
Net Cash requirements	95	115	136	118	108
Liquidity buffer	48	58	68	59	54
New commitments (signed)	**150**	**200**	**240**	**258**	**263**
New BoD approved	**180**	**222**	**273**	**294**	**301**
Disbursements	179	191	206	242	258
Reimbursement	160	119	119	123	134
Total outstanding disbursements (B/S)	**598**	**670**	**757**	**877**	**1,000**
Total signed undisbursed	71	90	106	87	71
BoD approved not signed	81	69	64	61	60
Operational Gearing Ratio	***1,405***	***1,498***	***1,588***	***1,682***	***1,779***
Results					
Number of operations (Newly signed that yea	15	20	24	26	26
Operations per Banking team (newly signed)	3.0	4.0	4.8	5.2	5.3
Productivity volume (operation per banker)	1.07	1.18	1.33	1.43	1.46
Planning target (amount per Banking Tear	**29.94**	**40.02**	**48.03**	**51.63**	**52.66**
Direct Operational Staff/Total Staff	31.63%	33.96%	34.86%	35.45%	35.45%
Staff costs per capita	0.099	0.104	0.090	0.093	0.098
Growth in gross Loans outstanding (B/S)	***2.82%***	***12.03%***	***13.02%***	***15.74%***	***14.10%***
Ratios					
Capital	472	506	538	573	613
ROAE	2.34%	1.90%	1.33%	1.87%	2.43%
ROAA	1.39%	1.17%	0.78%	1.11%	1.31%
Cost/Income Ratio (before provisioning)	44.44%	52.82%	53.70%	46.90%	43.29%
Equity/Total Assets	70.48%	55.56%	61.12%	57.80%	50.85%
Loan loss provisions/total loans (end of year)	6.25%	6.26%	6.18%	5.99%	5.78%
Operating Income / Direct Operational Staff	935,913	771,832	667,095	770,903	870,833
Revenues after opex/revenues before opex	39.53%	33.42%	27.69%	33.33%	33.44%
Outstanding funds/Average staff	6.10	6.57	7.05	8.01	9.09

Note: Direct Operational Staff include professional staff in banking, financial analysis, economic, environment, procurement, risk management, legal and monitoring.

INCOME STATEMENT	2010	2011	2012	2013	2014
Interest and Similar Income					
Interest on loans	25.85	32.33	35.56	42.00	50.04
From placements with Financial Institutions	0.64	0.74	1.06	1.45	2.86
From Investment Securities	4.41	3.11	2.92	1.72	2.00
Total Interest and Similar Income	**30.90**	**36.18**	**39.54**	**45.17**	**54.91**
Interest Expenses and Similar Charges					
Interest Expenses	9.04	11.21	16.24	17.18	22.99
Other Charges	1.80	0.05	0.05	0.05	0.05
Total Interest Expenses and Charges	**10.84**	**11.26**	**16.29**	**17.23**	**23.04**
Net interest Income	**20.06**	**24.93**	**23.25**	**27.94**	**31.87**
Other Income					
Net Fees and Commissions	3.35	2.86	2.10	2.12	2.09
Net Income (Loss) on Forex	0.60	0.00	0.00	0.00	0.00
Other Income	5.00	0.00	0.00	0.00	0.00
Total Other Income	**8.95**	**2.86**	**2.10**	**2.12**	**2.09**
Operating Income	**29.01**	**27.79**	**25.35**	**30.07**	**33.96**
Administrative Expenses					
Total salaries and benefits	9.68	10.98	9.83	10.24	10.74
Other administration expenses	3.21	3.70	3.78	3.86	3.97
Depreciation	**0.37**	**0.06**	**0.21**	**0.20**	**0.20**
Total Administrative Expenses	**12.89**	**14.68**	**13.61**	**14.10**	**14.70**
Income before provisions	**15.75**	**13.05**	**11.53**	**15.76**	**19.06**
Provisions	**5.98**	**3.78**	**4.58**	**5.36**	**4.64**
Net profit	**9.78**	**9.27**	**6.95**	**10.40**	**14.43**
Deferred Income (equity)	**0.70**	**1.02**	**1.46**	**1.81**	**2.42**
TOTAL PROFIT	**10.47**	**10.29**	**8.41**	**12.21**	**16.85**

BALANCE SHEET	2010	2011	2012	2013	2014
Assets					
Cash and bank balances	27.64	10.00	10.00	10.00	10.00
Placements with financial institutions	50.87	86.58	91.93	88.46	181.21
Investment securities	27.97	180.00	60.00	60.00	60.00
Total deposits and securities/Liquidity	**106.48**	**276.58**	**161.93**	**158.46**	**251.21**
Derivative financial instruments	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Loans	585.00	644.58	726.67	839.82	950.53
Equity investments	13.28	25.66	30.82	36.87	49.77
Less: provisions for impairment	-36.58	-40.36	-44.94	-50.30	-54.94
Net loans and equity investments	**561.70**	**629.88**	**712.55**	**826.39**	**945.37**
Receivables and accrued interest	**4.06**	**5.48**	**7.06**	**8.68**	**10.28**
Paid-in share capital not received	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Property, technology and equipment	0.20	2.00	1.95	1.90	1.85
Intangible assets	0.57	0.57	0.57	0.57	0.57
Less: accumulated depreciation	-3.75	-3.81	-4.01	-4.22	-4.41
Net property, technology and equipment	**-2.97**	**-1.24**	**-1.49**	**-1.74**	**-1.99**
Other assets	**0.00**	**0.00**	**0.00**	**0.00**	**0.00**
Total assets	**669**	**911**	**880**	**992**	**1,205**
Liabilities					
Borrowing	**189.89**	**397.07**	**334.46**	**410.81**	**584.45**
Payables and accrued interest	2.82	2.82	2.82	2.82	2.82
Deferred income	4.87	4.87	4.87	4.87	4.87
Other liabilities	0.03	0.03	0.03	0.03	0.03
Total liabilities	**197.61**	**404.79**	**342.18**	**418.53**	**592.17**
Paid-in share capital	**400.00**	**425.00**	**450.00**	**475.00**	**500.00**
General reserve	**27.69**	**36.95**	**43.90**	**54.30**	**68.73**
Surpluses	**43.99**	**43.99**	**43.99**	**43.99**	**43.99**
Total Equity	**471.68**	**505.95**	**537.90**	**573.30**	**612.72**
Total own funds and liabilities	**669**	**911**	**880**	**992**	**1,205**



D3. Sensitivity Analysis

Under the Base Case Scenario the Bank remains within the limits of manageable growth. Its continued ability to fulfill its mandate would not be jeopardized by over-ambitious rapid expansion, given the prevailing environment characterized by high risk and uncertainty. Under such market conditions, sensitivity analysis becomes even more relevant. In addition to normal risk factors, uncertainties are likely to influence the Bank's performance to a greater degree than in the past.

The risks most likely to be faced in the current environment, if growth rates in the operational portfolio of outstanding operations are pushed beyond what can be reasonably expected to be managed, are:

- incomplete due diligence and appraisal process;
- adverse selection of clients and operations;
- lower profitability (as a result of higher borrowing needs at high rates, higher provisioning needs, higher administrative costs);
- insufficient time and man-power allocated for supervision and monitoring, with the resulting risk of potential deterioration of the existing portfolio;
- changes to the profile of obligors and quality of facilities offered by the Bank, relative to the conditions and situation prevailing at the time of approval, due to adverse economic conditions;

- recruitment of new staff in senior position without the requisite mix of skills and experience.

The other main concern for the Bank is market risk arising from volatility and its implication on the bottom line through repricing. The issues to consider are the following:

- The cost of borrowed funds is a variable of amount and timing. If the Bank would need a large amount of money (USD 300 million and above) for a longer period of time, a 3 or 5 year bond issue looks preferable. For smaller amounts and shorter maturities, bi-lateral deals (IFIs, commercial banks etc) would appear more appropriate – current estimated pricing LIBOR + 300 to 350 basis points.
- The big picture affecting credit spread costs for all institutions could equally go either up or down. Absolute levels of interest rates are more likely to go up. However, whether it is the base rate or the margin that goes up makes a large difference; increases in the base rate favor the Bank (through its earnings on equity capital and retained earnings), while increases in the borrowing margins would have a negative impact.
- Funding for early 2011 is substantially completed. For funding in subsequent years visits are planned this and next year to potential lenders – this will be driven by either promoting a bond issue or the establishment of relationships for future funding needs.
- Potential sources of funds for BSTDB need to be diversified, and the institution needs to improve outreach beyond Europe to additional potential investors in areas such as the Middle East, East Asia, and the USA.

Further, interest and exchange rate volatility may impact the Bank through various channels:

- With an estimated average capital of SDR 425 million in 2010, a 1% change in interest rate would impact the Bank by SDR 4.25 million. For capital of SDR 600 million in 2014, the impact would be equal to SDR 6 million.
- Estimating the impact of exchange rate volatility is more difficult. Estimated major currency components are:
  - Administrative Expenses - EUR 15 million;
  - USD Margin Expenses on Borrowing - USD 7.5 m;
  - EUR Margin Expenses on borrowing - EUR 0.8 m;
  - USD Margin Income (3.8% * Avg Portfolio in USD 600m) - USD 22.8 m;
  - EUR Margin Income (3.8% * Avg Portfolio in EUR 200m) - EUR 7.6 m;
  - Fees USD 2.1 m and EUR 0.69 m.

Adding these components gives: + USD 17.4 million and - EUR 7.51 million.

On the assumption that the USD and Euro will move in opposite directions against the SDR then an instant move of 1% would impact P/L by USD 174 K and EUR 75.1 k. A gradual move of 1% during the year would be hedged monthly and so would have roughly 50% impact.

An additional source of vulnerability is represented by uncertainty (defined as events that cannot be predicted). Uncertainty adds to risk factors, is partly responsible for volatility, and may impact the Bank through availability of funds and ability to recruit.

Uncertainties which would affect the ability of the Bank to achieve the Base Case Scenario may include events such as the world economy, or the Black Sea region, relapsing into new crises, or if global demand fails to recover and Member States are faced with lower rates of economic growth, destabilizing exchange rate movements, interest rate volatility, or negative developments regarding liquidity availability. Credit markets may freeze, with limited availability of funds, irrespective of the cost of such funds. Such events would affect the ability of the Bank to access capital markets in an affordable unfettered manner.

As far as staff is concerned, the Bank has experienced difficulties in externally recruiting staff with desirable skills and experience. Although the Bank is one of the most cost effective MDBs among its peer group of institutions (as reflected by the Administrative expense per staff and Committed volume per administrative expenses ratios), this cost consciousness may have reduced the attractiveness of the Bank as a potential employer. The Bank will therefore need to review the conditions which led to the inability to attract, and also to the relative difficulties to retain, staff in the past year. The review process will look at the facts from four dimensions:

(i) The general availability of staff with required skills and experience (if this is the case the Bank would then need to consider hiring mainly junior staff who would be given opportunities to grow professionally in the institution, while also providing a conducive work environment and job security);

(ii) the Bank's work culture and environment (including job classification, compensation, recognition and reward, potential for professional development, job security, etc);

(iii) the recruitment process (identification of needs, planning, advertisement and selection); and,

(iv) the general public awareness and visibility of the Bank (in this case promotional events might be necessary, among other types of activities).

Depending on the findings of such a review, adequate measures would be adopted with BoD approval where appropriate. The Bank gives due consideration to potential fluctuations in economic fundamentals and variables, as well as to other positive or negative market developments. It will therefore carefully monitor implementation of its Financial Plan under the BCS and depending on circumstances will review either its growth targets or path of growth to respond to changing market conditions and to ensure its relevance and financial stability.

Alternative growth solutions

D4. High Case Scenario

An increased focus on longer term operations in the infrastructure and energy sectors might result in an extension of the average maturity, towards 10 years, and the slower turnover of the operational portfolio may lead to a more rapid increase in the size of the portfolio of outstanding operations. The restrictions of this alternative scenario are: (i) the Bank would have to hire new specialized staff with required skills and experience; and (ii) necessary funds would need to be available on acceptable terms. With these provisos in mind, and if a sustained regional economic recovery takes shape, the alternative higher growth may be achieved with a combination of

greater intensive (higher amounts per front-office staff) and extensive (higher number of operational staff) activity compared to the Base Case Scenario.

In case of higher growth rates and increased demand for Bank funding, a phased increase in the average size of operations would allow the Bank to reach a total outstanding portfolio of SDR 1.2 billion and a Balance sheet size of SDR 1.35 billion.

The assumptions under which the High Case Scenario was developed are the following:

- The outstanding portfolio will reach SDR 1.2 billion.
- The average annual growth rate of the outstanding portfolio is 19.0%.
- The amount of newly signed operations per front office staff per year is SDR 13.5 million.
- The amount of new BoD operation approvals increases from SDR 240 million in 2011 to SDR 320 million in 2014.
- Average loan maturity of an operation at the time of signing is 6 years (2 years availability and grace period, 4 years of repayment in equal installments).
- As the complexity of operations increases, the appraisal process would be lengthier and more intense.
- A steady economic recovery of 4% is projected for the Black Sea region, and capital markets normalize- meaning that access to credit becomes easier over time, albeit at a higher rate than prior to the crisis.
- Member States pay their contribution to the capital increase in full and on time.
- The accession of new member(s) as shareholders from among AAA rated development finance institutions is finalized and they become member(s) by end 2012.
- The net change in staff numbers up to 2014 relative is an increase of 14-22 professional staff.
- The Risk margin declines over time as a result of anticipated risk rating upgrades of Member Countries, and the good quality of the Bank's portfolio.
- The cost of borrowed funds declines over time as a result of the improvement in the Bank's risk rating to A2 (from Moody's). A jump to A1 occurs when the AAA rated development finance institution joins. The Bank would seek a second rating from a leading credit rating agency in order to improve further its access to capital markets, and may even consider a third if it determines that this would help improve access to markets further.
- By 2014 about 7.5% of disbursements will be equity investments.
- To finance the growth in operations, the Bank will increase total borrowing by about an additional SDR 150 million on a net basis. If this does not prove possible, it may still be possible to achieve the growth in amounts outstanding by offering guarantees, for mobilization of external financing.
- The Treasury will assume an increased role as a profit center, but banking operations will continue to play a larger role as a profit center in relative terms. The main concern of the

Treasury will be to secure the funds necessary for Banking operations. In case of funds remaining underutilized, the Treasury would seek profitable investments.

- Net income will be positive and on an upward trend, growing from about SDR 10 million in 2011 to approximately SDR 20 million in 2014.
- Provisions are assumed to reflect the relationship between the Risk Margin and the portfolio quality. There are no actual write-offs and recoveries forecast for the period covered by the Business Plan.

The expected developments under the HCS are presented in the following table:

Table 8: Main Indicators High Case Scenario

INDICATORS SDR mil.	2010	2011	2012	2013	2014
Operating Assumptions					
Avg. Staff	98	106	110	114	114
Avg. Loan maturity	6.00	6.00	6.00	6.00	6.00
Amount per operation	10.00	10.00	10.00	10.00	10.00
Financial Assumptions					
Base Rate (return on liquid assets)	1.39%	1.08%	1.19%	1.61%	2.12%
Cost of Borrowed Funds (Above Base Rate)	2.90%	3.25%	3.00%	2.75%	2.50%
Average cost of funds	0.78%	1.00%	1.23%	1.38%	1.35%
Interest on loans	5.21%	4.93%	5.27%	5.49%	5.72%
Net Cash requirements	62	100	115	133	144
Liquidity buffer	31	50	57	66	72
New commitments (signed)	**150**	**210**	**252**	**283**	**283**
New BoD approved	**161**	**240**	**287**	**323**	**323**
Disbursements	186	210	281	314	322
Reimbursement	169	112	135	106	165
Total outstanding disbursements (B/S)	**596**	**695**	**841**	**1,048**	**1,205**
Total signed undisbursed	40	80	90	99	100
BoD approved not signed	64	60	58	58	57
Operational Gearing Ratio	*1,406*	*1,498*	*1,592*	*1,688*	*1,790*
Results					
Number of operations (Newly signed that yea	15	21	25	28	28
Operations per Banking team (newly signed)	3.0	4.2	5.0	5.7	5.7
Productivity volume (operation per banker)	1.07	1.23	1.32	1.41	1.41
Planning target (amount per Banking Tear	**29.94**	**41.92**	**50.31**	**56.59**	**56.59**
Direct Operational Staff/Total Staff	31.63%	33.96%	35.45%	36.84%	36.84%
Staff costs per capita	0.076	0.083	0.085	0.088	0.092
Growth in gross Loans outstanding (B/S)	*2.51%*	*16.43%*	*21.06%*	*24.70%*	*14.93%*
Ratios					
Capital	473	507	542	579	623
ROAE	2.68%	1.76%	1.97%	2.17%	3.16%
ROAA	1.62%	1.24%	1.24%	1.16%	1.50%
Cost/Income Ratio (before provisioning)	39.77%	44.29%	39.09%	36.33%	34.07%
Equity/Total Assets	72.38%	68.50%	58.44%	49.44%	45.67%
Loan loss provisions/total loans (end of year)	5.81%	5.77%	5.73%	5.52%	5.36%
Operating Income / Direct Operational Staff	781,300	690,844	766,786	812,833	904,920
Revenues after opex/revenues before opex	40.28%	40.70%	41.94%	38.79%	36.10%
Outstanding funds/Average staff	6.09	6.81	7.79	9.36	10.57

D5. Low Case Scenario

Alternatively, under continued adverse global and regional conditions (or if new crises arise), the Bank may face difficulties in achieving its targeted goals. This may come as a result of constraints arising from the diminished availability of resources, both financial and human. In this case the Bank would only achieve at the end of the planning period an outstanding portfolio of operations of SDR 800 million, with a balance sheet size of SDR 870 million. The assumptions under which the Low Case Scenario was developed are the following:

- The outstanding portfolio will reach SDR 800 million, and the Balance Sheet size would amount to about SDR 870 million at end 2014.
- The average annual growth rate of the outstanding portfolio is 7.5%.
- The amount of newly signed operations per front office staff per year is SDR 7 million.
- Average loan maturity of an operation at the time of signing is 6 years (2 years availability and grace period, 4 years of repayment in equal installments).
- For the Black Sea region, a very weak economic recovery is projected of below 2% per annum. Growth in the European Union is even weaker, while financial markets remain volatile and unpredictable; where funding is available, it is expensive.
- Payment of the contribution to the capital increase of Member States is made in full, but with significant delays in certain cases.
- The accession of new member(s) as shareholders from among AAA rated development finance institutions is not finalized.
- The net change in staff numbers up to 2014 relative to the current figures budgeted for 2010 is below planned numbers due to reduced availability of professional staff with required skills and/or experience; therefore, staff numbers will only increase by four, with only one in front office and one in credit appraisal functions.
- The Bank does not receive a further credit rating upgrade. The Bank would seek a second rating in addition to that from Moody's from a leading credit rating agency in order to improve further its access to capital markets.
- The Bank will sign every year new operations between SDR 120 million and SDR 140 million. By 2014 less than 5% of disbursements will be equity investments.
- To finance the growth in operations, the Bank will increase total borrowing by about SDR 30 million on a net basis every year starting with 2013. If this is not feasible, it may still be possible to achieve the growth in outstanding by offering guarantees, for mobilization of external financing.
- The Treasury will play a reduced role as a profit center. The main concern of the Treasury will be to roll over the funds necessary for Banking operations, although the marginal cost of such transactions would be higher than for past borrowing. In case of funds being underutilized, the Treasury would seek profitable investments.
- Net income will average approximately SDR 11-12 million per annum.

Table 9: Main Indicators Low Case Scenario

INDICATORS SDR mil.	2010	2011	2012	2013	2014
Operating Assumptions					
Avg. Staff	98	102	102	102	102
Avg. Loan maturity	6.00	6.00	6.00	6.00	6.00
Amount per operation	10.00	9.00	8.00	6.50	6.25
Financial Assumptions					
Base Rate (return on liquid assets)	1.39%	1.08%	1.19%	1.61%	2.12%
Cost of Borrowed Funds (Above Base Rate)	2.90%	3.25%	3.25%	3.00%	3.00%
Average cost of funds	0.78%	0.85%	0.81%	0.79%	0.84%
Interest on loans	5.21%	4.68%	4.75%	4.90%	5.21%
Net Cash requirements	62	82	97	94	96
Liquidity buffer	31	41	49	47	48
New commitments (signed)	**150**	**142**	**124**	**106**	**100**
New BoD approved	**161**	**163**	**142**	**121**	**115**
Disbursements	186	160	150	150	142
Reimbursement	169	111	111	82	90
Total outstanding disbursements (B/S)	**596**	**646**	**685**	**754**	**805**
Total signed undisbursed	40	63	77	73	72
BoD approved not signed	64	58	53	48	44
Operational Gearing Ratio	***1,406***	***1,498***	***1,592***	***1,687***	***1,786***
Results					
Number of operations (Newly signed that yea	15	16	16	16	16
Operations per Banking team (newly signed)	3.0	3.2	3.1	3.3	3.2
Productivity volume (operation per banker)	1.07	1.05	1.04	1.09	1.07
Planning target (amount per Banking Tear	**29.94**	**28.45**	**24.89**	**21.16**	**20.10**
Direct Operational Staff/Total Staff	31.63%	32.35%	32.35%	32.35%	32.35%
Staff costs per capita	0.080	0.086	0.088	0.091	0.095
Growth in gross Loans outstanding (B/S)	***2.51%***	***8.26%***	***6.04%***	***10.04%***	***6.86%***
Ratios					
Capital	473	507	542	579	619
ROAE	2.58%	1.80%	2.06%	2.10%	2.49%
ROAA	1.56%	1.31%	1.51%	1.54%	1.80%
Cost/Income Ratio (before provisioning)	41.55%	49.38%	46.76%	43.90%	41.86%
Equity/Total Assets	72.29%	72.93%	74.26%	72.82%	71.40%
Loan loss provisions/total loans (end of year)	5.81%	5.80%	5.80%	5.71%	5.63%
Operating Income / Direct Operational Staff	781,499	686,855	742,562	812,730	889,499
Revenues after opex/revenues before opex	39.07%	37.14%	39.02%	41.03%	40.91%
Outstanding funds/Average staff	6.09	6.46	6.71	7.39	7.89

IV. IMPLEMENTATION and MONITORING

The Bank has developed a Strategy Map for the planning, implementation and monitoring of its Medium Term Strategy and Business Plan. The Bank's Business Plan will be implemented through Country Strategies, Annual Budgets, Divisional Action Plans, Departmental Work Programs, and individual Work Plans.

The Bank benchmarks itself against a selected peer group of MDBs. In addition to its own quantitative and qualitative budget targets and Key Performance Indicators (to be cascaded in a Balanced Scorecard multilevel environment), the Bank shall attempt to control developments against a set of Key Risk Indicators.

The Business Plan implementation and monitoring would include a mid-term review. Depending on developments a target revision may happen and/or corrective measures necessary to reflect changes in prevailing market and economic conditions may be taken.

Annex 1

Goals

- Increase total outstanding exposure from about SDR 600 million to SDR 1.0 billion by end 2014
- Increase Balance Sheet Size from about SDR 670 million to SDR 1.2 billion.
- Increase the share of public and quasi-public sector operations in total outstanding portfolio from about 20% at present to 25%.
- Increase the share of equity operations to 5-7.5% of the value of the outstanding portfolio from 1.4% at present; the 5% figure is a minimum to be achieved under the low case or base case scenarios, while the upper 7.5% would be the target under the high case scenario.
- Achieve an A2 risk rating from Moody's by 2014, as well as a comparable rating from a second leading credit rating agency.

Operational Targets

Intermediated Operations (in all countries)

Intermediated operations are planned to amount to approximately between 35% and 40%

The envisaged sectoral exposure limit is tentatively established as follows:

- Up to 65% of the intermediated operations for SMEs, including credit lines, guarantees and leasing operations;
- Up to 30% of the intermediated operations would be Trade Finance related products;
- Up to 15% of the intermediated operations would be financial sector activities, including bank-to-bank loans and mortgage facilities.

Cross- country operations

Cross country, energy and infrastructure operations are expected to reach approximately 10% of the total portfolio.

Direct Operations

Direct operations are targeted to amount to approximately 50-55% of the total portfolio with a focus on:

(i) large and medium sized corporations, which either are market leaders or have rapid growth and enjoy good economic prospect, able to provide a constant flow of income,

(ii) other viable private sector companies which suffer temporarily from either lack of availability or excessive interest cost of funding, and

(iii) entities in the public sector which need funding for operations with development impact.

By sector, direct operations are indicatively set at:

- Up to 30% of direct operations for transportation;

- Up to 25% of direct operations for manufacturing;
- Up to 35% for direct operations in energy
- Up to 20% of direct operations for other sectors- telecommunications, mining, construction, agriculture, services, etc.

Country strategies will provide further detail of target amounts and operational objectives in each shareholder country, for intermediated and for direct operations.

Breakdown of Operational Targets, by Type of Operation and Sector, 2010 & 2014

	Share in 2010 (End Sept.)	Targeted Share in 2014
Intermediated Operations	**36.2%**	**35-40%**
Of Which:		
SMEs	67.7%	55-65%
Trade Finance	25.1%	25-30%
Other Financial	7.2%	10-15%
Sub-Total	*100.0%*	
Cross Country	**N/A**	**10.0%**
Direct Operations	**63.8%**	**50-55%**
Of Which:		
Transportation	26.8%	25-30%
Manufacturing	22.3%	20-25%
Energy	29.9%	25-35%
Other	21.0%	10-20%
Sub-Total	*100.0%*	
TOTAL	**100.0%**	

Key Performance Indicators

INDICATOR	2009	2014
Mandate fulfillment – positive evaluations	65%	70%
Employment per SDR 1 million	140 (30/70/40)*	150 (35/70/45)*
Government revenue per SDR 1 million	50,000	50,000
Asset quality (NPL per loan portfolio)	1.89	Below 3%
Return on Average Assets	1.9 (2008)	1.3%
Concept Cleared – BoD Approved	60%	10% Targeted improvement
DoD approved to disburse > 50%	75%	5% Targeted improvement
Recognition for Contribution to Good Practice	3 cases	5 cases
Staff Contribution to Professional Events	6 cases	10 cases

Note: * The numbers in parenthesis reflect new jobs, preserved existing jobs, and indirect (supply chain) jobs, supported by the operation