

Annual report 2006

Financial report



European Bank
for Reconstruction and Development

The EBRD, owned by 61 countries and two intergovernmental institutions, aims to foster the transition from centrally planned to market economies in 29 countries from central Europe to central Asia.

The EBRD invests in virtually every kind of enterprise and financial institution, mainly in the form of loans and equity. Investments are designed to advance the transition to market economies and to set the highest standards of corporate governance. We do not finance projects that can be funded on equivalent terms by the private sector. In support of our investment activities, the EBRD conducts policy dialogue with national and local authorities to develop the rule of law and democracy.

Annual report 2006

Financial report

02 Highlights

03 Financial results

10 Additional reporting and disclosures

Financial statements

14 Income statement

15 Balance sheet

16 Statement of changes in members' equity

17 Statement of cash flows

18 Accounting policies

25 Risk management policies

37 Notes to the financial statements

53 Summary of Special Funds

Responsibility for external financial reporting

56 Management's responsibility

57 Report of the independent auditors

58 Independent auditors' report

The EBRD's Annual Report 2006 comprises two separate companion volumes: the Annual Review and the Financial Report, which includes the financial statements and the financial results commentary.

Both volumes are published in English, French, German and Russian. Copies are available free of charge from the EBRD's Publications Desk:

One Exchange Square
London EC2A 2JN
United Kingdom
Tel: +44 20 7338 7553
Fax: +44 20 7338 6102
Email: pubsdesk@ebrd.com

Highlights

Financial results 2002–06

(€ million)	2006	2005 ¹	2004 ¹	2003 ¹	2002 ¹
Operating income	2,667	1,544	659	538	331
Expenses, depreciation and amortisation	(225)	(219)	(190)	(198)	(219)
Operating profit before provisions	2,442	1,325	469	340	112
Provisions for impairment of loan investments	(53)	197	(76)	(7)	(26)
Net profit for the year	2,389	1,522	393	333	86
Reserves and retained earnings	6,974	4,684	1,718	952	655
Provisions for impairment of loan investments (cumulative)	341	323	508	465	535
Total reserves and provisions	7,315	5,007	2,226	1,417	1,190

¹ Amendments to International Financial Reporting Standards in 2006 have resulted in a change to the Bank's accounting policy in relation to financial guarantees, as explained in the "Accounting policies" section of the financial statements on page 18. The figures from previous years have been restated to conform to the new accounting policy.

Annual commitments 2002–06

	2006	2005	2004	2003	2002	Cumulative 1991–2006
Number of projects ¹	301	276	265	222	178	2,268
consisting of:						
– standalone projects	167	156	141	129	105	1,392
– investments under frameworks	134	120	124	93	73	876
EBRD commitments (€ million)	4,936	4,277	4,133	3,721	3,899	33,348
Resources mobilised (€ million)	8,915	6,222	8,799	5,307	4,862	69,571
Total project value (€ million)	13,851	10,499	12,932	9,028	8,761	102,919

¹ The calculation of the number of projects signed by the EBRD has been simplified to reflect the actual number of operations to which the Bank made commitments during the year. Previously, the measure was weighted, assigning proportional values to partially signed operations and individual investments under frameworks. An operation that is not linked to a framework and involves only one client is referred to as a standalone project. Operations extended to a number of clients (for example, credit lines to banks) have a framework, which represents the overall amount approved by the Board. Investments under frameworks represent the commitment to individual clients.

Financial results

The EBRD recorded a net profit after provisions of €2.4 billion for 2006, compared with €1.5 billion for 2005. The principal factors contributing to this increase were significant realised gains from the sale of share investments and unrealised gains from the movement in the fair value of the Bank's associate share investments and high-risk equity funds, both areas that are variable by nature.

The EBRD's general administrative expenses including depreciation and amortisation for the year of €225 million (2005: €219 million) were within budget, reflecting continuing budgetary discipline and effective cost control.

Banking operations achieved a net profit of €2.3 billion (2005: €1.5 billion) after the full allocation of expenses, provisions and the return on net paid-in capital. This reflected a year-on-year increase in realised gains from the sale of share investments, together with unrealised gains on the movement in fair value of the Bank's associate share investments and high-risk equity funds. Treasury operations achieved a net profit of €78 million (2005: €62 million), after full allocation of expenses, the return on net paid-in capital and the movement on non-qualifying hedges. This reflected improved returns on both investment and dealing activity, including increased profits from buy-backs.

Total provisions for Banking loan operations on an incurred loss basis amounted to €341 million at the end of 2006 (2005: €323 million). Relative to operating assets, this represented 0.7 per cent of sovereign loans (2005: 0.7 per cent) and 4.8 per cent of non-sovereign loans (2005: 5.3 per cent). The increase in provisions was a result of a growth in operating assets during the year.

The Bank's reserves increased from €4.7 billion at the end of 2005 to €7.0 billion at the end of 2006. This primarily reflected the net profit for the year. The Bank's total

reserves comprised €3.1 billion (2005: €2.5 billion) of unrealised gains from share investments, equity derivatives and Treasury assets. The loan loss reserve stood at €293 million (2005: €292 million) and the special reserve stood at €215 million (2005: €188 million). This left unrestricted general reserves of €3.4 billion (2005: €1.7 billion). The increase in unrestricted general reserves of €1.7 billion in the year mainly reflected the net profit for the year of €2.4 billion, less unrealised gains on associate share investments and equity derivatives of €754 million.

Banking operations

Annual business volume and portfolio

Annual business volume¹ amounted to €4.9 billion, comprising 301 projects in 2006 (2005: €4.3 billion, 276 projects). This is the highest level of annual commitments signed by the EBRD to date. It represents an increase of 14 per cent over the level recorded in 2005 in volume terms, and a 9 per cent rise in the number of transactions. Share investments and equity-linked transactions accounted for 23 per cent of the new business volume (2005: 16 per cent). The private sector share of the business volume was 80 per cent (2005: 76 per cent). Annual business volume included €99 million of restructured operations (2005: €131 million).

Net cumulative business volume reached €33.3 billion by the end of 2006 (2005: €30.3 billion). Including co-financing,

this amounted to a total project value of €102.9 billion (2005: €94.4 billion). The portfolio of the Bank's net outstanding commitments grew from €16.8 billion at the end of 2005 to €17.7 billion at the end of 2006. Strong reflows, reflecting an exceptionally liquid financial market and a maturing portfolio, together with the strengthening of the euro relative to the dollar, limited the portfolio impact of annual business volume and restricted portfolio growth to 5 per cent.

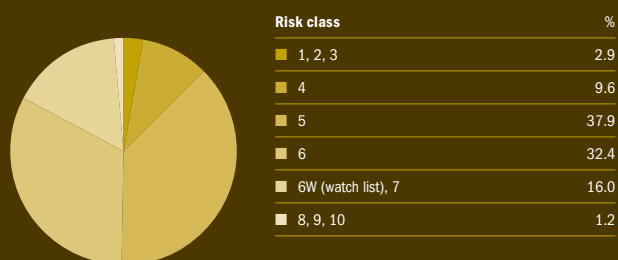
The number and volume of projects under development increased during 2006, with the Board approving 181 projects. These consisted of loans and share investments by the Bank totalling €5.1 billion, compared with 165 projects totalling €4.8 billion in 2005. The level of Board approvals in 2006 was the highest annual level to date. At the end of 2006, cumulative Board approvals, net of cancellations, totalled €37.6 billion (2005: €33.8 billion).

Gross disbursements totalled €3.8 billion in 2006, up from €2.3 billion² in 2005. Operating assets amounted to €13.4 billion at the end of 2006 (2005: €12.0 billion), comprising €8.3 billion of disbursed outstanding loans (2005: €7.8 billion) and €5.1 billion of disbursed outstanding share investments at fair value (2005: €4.2 billion).

The Bank attracted a significant additional amount of co-financing funds in 2006, which reached €4.0 billion (2005: €2.6 billion). The Bank mobilised €2.6 billion

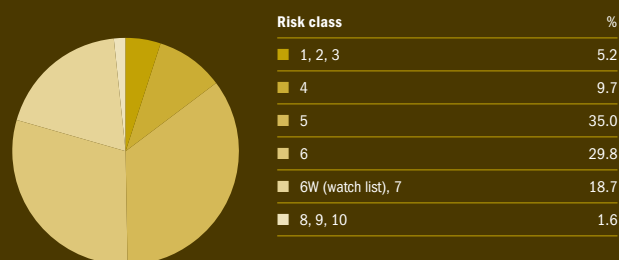
Credit quality of the Banking portfolio

31 December 2006



Note: Risk ratings range from 1 (lowest risk) to 10 (highest risk).

31 December 2005



Note: Risk ratings range from 1 (lowest risk) to 10 (highest risk).

from commercial co-financing institutions (2005: €1.9 billion), €629 million from official co-financing (2005: €338 million), €788 million from international financial institutions (2005: €326 million) and €38 million from export credit agencies (2005: €42 million). In addition, the Bank's activities continued to be strongly supported by donor funding, including the Special Funds programme and technical and investment cooperation funds.

Portfolio risks

Internal rating procedures are discussed in detail under "Banking credit risk" in the risk management policies section of the financial statements. All projects and countries of operations are assigned credit risk ratings on an internal scale from 1 (lowest risk) to 10 (highest risk).

In view of the markets in which it operates and its transition mandate, the EBRD expects the majority of its project ratings in normal circumstances to range from risk categories 4 to 6 (approximately equivalent to Standard & Poor's BBB to B ratings) at the time of approval. At 31 December 2006, 79.9 per cent of the loan and share investment portfolio was classed under risk ratings 4 to 6 (2005: 74.5 per cent) (see charts on page 4).

The credit risk of the EBRD's portfolio continued to show improvement in 2006. This reflected the strong economic performance in Russia, the continuing integration of a number of countries of

operations within the European Union (EU) and a generally resilient economic performance across much of the region. This trend led to the upgrading of several countries of operations' credit ratings by independent rating agencies and the Bank's own internal rating process. The size of the classified portfolio (loans and share investments in risk rating categories 7 to 10) remained broadly stable over 2006. There was also a further decline in the level of impaired assets, continuing the steady downward trend since December 2000.

Impaired assets

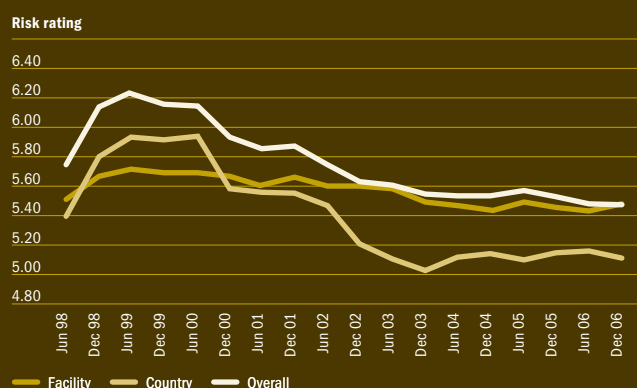
Where there is objective evidence that an asset is impaired, the difference between the historic cost of the loan and the net present value of its expected future cash flows is recognised in the income statement. Impaired share investments are defined as investments where there is objective evidence that impairment has been incurred and the future recoverability of the Bank's original investment is therefore in doubt. Although projects are usually reviewed for impairment every six months, or, in the case of low risk projects, at least once a year, certain events may trigger this process sooner and more frequently. In such cases, future collectability is considered and any necessary specific provision or fair value adjustment for impairment is made.

The chart (below right) illustrates the historical development of the Bank's impaired assets.

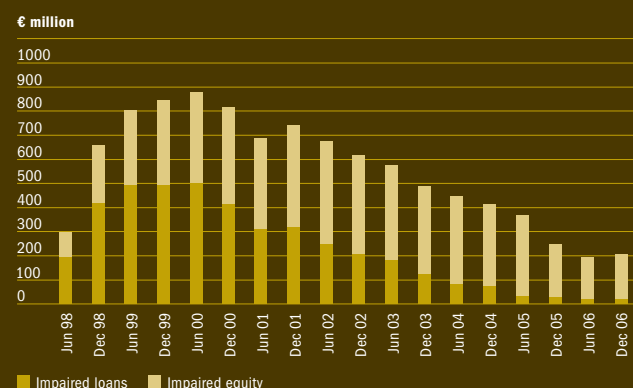
¹ The flow of commitments made by the Bank within a period (since the start of the year), less cancellations or sales of such commitments within the same time period.

² The gross disbursement figure for 2005 of €2.2 billion has been restated to €2.3 billion. This reflects a change during the year in the Bank's measurement basis for gross disbursements to include first cycle disbursements relating to revolving loan facilities.

Facility, overall and country weighted average risk ratings



Impaired assets



The Bank's impaired assets peaked in mid-2000, largely reflecting the after-effects of the crisis in Russia in 1998. Since then, through improvements in, or successful restructuring of, a number of projects and through some write-offs, the level of impaired assets has declined substantially. At 31 December 2006, impaired assets amounted to 1.9 per cent of net outstanding disbursements, compared with 2.5 per cent at 31 December 2005 and 10.8 per cent at 31 December 2000. Net write-offs (after recoveries from previously written-off projects) were €43 million in 2006 (2005: €57 million).

Financial performance

Banking operations recorded a net profit (after fully allocated expenses, provisions and the allocation of the return on capital) of €2.3 billion for 2006, compared with a net profit of €1.5 billion in 2005. There were two principal factors that contributed to this increase: (i) significant realised gains from the sale of share investments of €1.3 billion, compared with €640 million in 2005; and (ii) unrealised gains from the movement in the fair value of the Bank's associate share investments, high-risk equity funds and equity derivatives of €755 million (2005: €375 million).

The contribution from share investments to the Bank's income statement is expected to continue to show significant variability from year to year, given its dependence on the timing of share investment exits. These are mainly linked to the completion of the Bank's transition role in the specific operation and the

opportunity, in the market or otherwise, to sell its holding. Given the volatility of equity markets, further variability is also expected as a result of movements in the fair value of associate share investments, high-risk equity funds and equity derivatives accounted for in the income statement.

Treasury operations

Portfolio

The value of assets under Treasury management was €14.3 billion at 31 December 2006 (2005: €12.9 billion). This comprised €8.6 billion of debt securities (2005: €7.6 billion), €2.6 billion of collateralised placements (2005: €1.5 billion) and €3.1 billion of placements with credit institutions, including repurchase agreements (2005: €3.8 billion).

At the end of 2006, 3.2 per cent of Treasury assets were managed by a total of nine external asset managers (2005: 3.6 per cent). The externally managed portfolios comprised €20 million (2005: €20 million) in a euro-denominated interest rate trading programme,³ and €440 million (2005: €443 million) in a US dollar-denominated triple-A-rated mortgage-backed securities programme. The funds are managed by independent managers in order to obtain specialised services and investment techniques and to establish third-party performance benchmarks. These independent managers are required to comply with the same investment guidelines that the Bank applies to its internally managed funds.

Treasury risks

For monitoring purposes, the Bank distinguishes between market, credit and operational risks, together with liquidity and settlement risks.

Market risk

At 31 December 2006, the aggregate Value-at-Risk (VaR)⁴ of the Bank's Treasury portfolio, calculated by reference to a 99 per cent confidence level and over a 10-trading-day horizon, stood at €1.7 million⁵ (2005: €3.2 million).

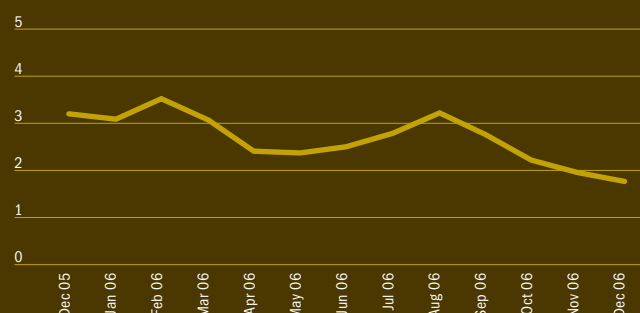
The month-end VaR⁶ values displayed in the chart (below left) denote a modest use throughout the year of the Board-approved total VaR limit for all Treasury funds, which amounts to €18.0 million (2005: €18.0 million). The average VaR over the year was €2.6 million (2005: €3.3 million), while the lowest and highest values were €1.7 million and €3.5 million respectively (2005: €2.7 million and €4.2 million).

Within the overall market risk exposure, the VaR of the internally managed portfolios stood at €0.9 million at the end of 2006 (2005: €1.8 million). It ranged during the year between €0.9 million and €1.9 million (2005: between €0.6 million and €4.7 million). The size of the internally managed portfolio to which these figures relate was €13.7 billion at 31 December 2006 (2005: €12.4 billion).

Total VaR – overall limit €18 million

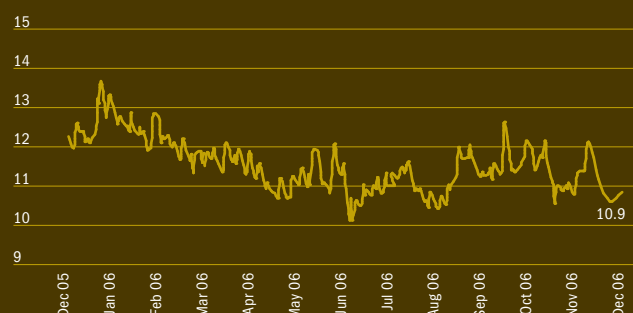
(10 trading days, 99% confidence level, BIS compliant dataset)

VaR (€ million; month-end figure)



Evolution of the overall Treasury credit exposure in 2006

€ billion



Market risks incurred on the externally managed portfolios exhibited a year-end VaR of €0.3 million (2005: €0.7 million) for the euro-denominated programme and €0.7 million (2005: €0.8 million) for the US dollar-denominated programme.

The specific contribution from foreign exchange risk to the overall VaR stood at €0.5 million at the end of 2006 (2005: €0.1 million). As in previous years, this contribution was small throughout 2006 and never exceeded €1.2 million (2005: €0.9 million). Interest rate positioning continued to represent the majority of the Bank's market risk exposure. Interest rate option exposure remained modest throughout the year especially at the end of the year, where, as in 2005, options VaR was negligible.

Credit risk

Treasury peak credit exposure decreased year-on-year, standing at €10.9 billion at 31 December 2006, compared with €12.2 billion at 31 December 2005 (see chart on page 6). This decrease, which occurred mostly during the first half, was partly linked to the depreciation of the US dollar against the euro (a substantial proportion of Treasury's assets are denominated in US dollars, whereas credit exposure is measured in euros) and partly due to a switch from cash instruments to collateralised instruments (for example, reverse repurchase agreements).⁷

Overall, the credit quality of the Treasury portfolio improved: the average credit rating⁸ weighted by peak counterparty exposure stood at 1.78 at 31 December 2006 (2005: 1.83).

The percentage of Treasury transactions of investment grade quality⁹ also improved (97.9 per cent at the end of 2006, compared with 97.3 per cent the previous year), as impaired assets continued to amortise (see charts below). Treasury is exposed to some below-investment-grade issuers due to the rating downgrades several years ago of a few asset-backed securities (ABS) investments that were originally rated triple-A by leading external rating agencies.

Financial performance

Treasury operations recorded an operating profit of €92 million in 2006 after the full allocation of expenses and return on capital but before the fair value movement on non-qualifying hedges. This compared with an operating profit of €56 million on the same basis for 2005. After the €14 million charge on the movement on non-qualifying hedges (2005: credit of €6 million), the profit on Treasury operations for the year totalled €78 million (2005: €62 million).

³ In the euro programme, managers are assigned notional amounts for interest rate positioning. At 31 December 2006, the notional value of the programme was €355 million (2005: €359 million).

⁴ Figures presented here are based on 99 per cent 10-day VaR, to enable comparisons between institutions. Market risk is, however, monitored daily for internal purposes in 95 per cent one-day expected shortfall (eVaR) terms, with the limits set in corresponding units. The Board-approved Treasury and Treasury Risk Management Authority (T&TRMA), dated 2 April 2004, adopted eVaR to replace VaR as the Bank's preferred methodology for measuring its exposure to interest rate and foreign exchange risks. Values of eVaR had been monitored for several years before being adopted for limit-setting purposes; similarly, VaR results continue to be produced and monitored daily (see the "Risk management policies" section of this report on page 25 for definitions).

⁵ This means that the Bank had a 1 per cent chance of experiencing a loss of at least €1.7 million over a horizon of 10 trading days, due to adverse movements in interest rates and foreign exchange rates.

⁶ Market risk is monitored daily for the internally managed portfolios and the euro-denominated externally managed portfolio. For the US dollar-denominated externally managed portfolio, market risk data is produced weekly by an external risk information provider. All the results reported in this section refer to month-end data.

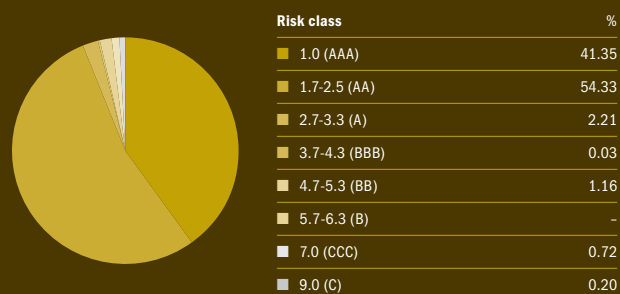
⁷ While exposure on collateralised instruments is based on a replacement cost type of calculation, exposure on cash instruments is on the full nominal amount.

⁸ Using the Bank's internal rating scale, where 1.7 is equivalent to an external rating of AA+/Aa1/AA+ with Standard & Poor's/Moody's/Fitch Ratings and 2.0 is equivalent to an external rating of AA/Aa2/AA.

⁹ BBB-/Baa3/BBB- level or above.

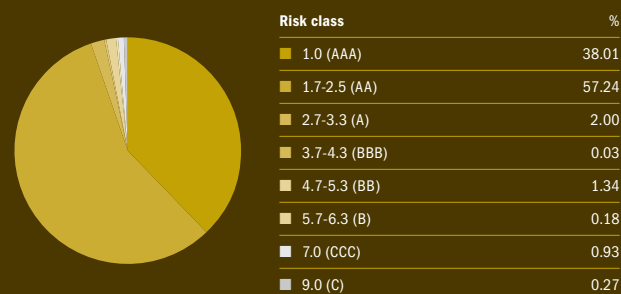
Credit quality of the Treasury portfolio

31 December 2006



Note: Risk ratings range from 1 (lowest risk) to 10 (highest risk).

31 December 2005



Note: Risk ratings range from 1 (lowest risk) to 10 (highest risk).

Funding

Borrowings

The EBRD's borrowing policy is governed by two key principles. First, it seeks to match the average maturity of the Bank's assets and liabilities to minimise refinancing risk. Second, it seeks to ensure the availability of long-term funds at optimum cost effectiveness for the Bank.

At 31 December 2006, total borrowings stood at €16.8 billion, a decrease of €92 million compared with 2005. There were 44 new issues in fully convertible new currencies under the EBRD's medium to long-term borrowing programme, at an average after-swap cost of LIBOR minus 38 basis points. The average remaining life of medium to long-term debt was 7.8 years at 31 December 2006, unchanged from the previous year-end. Some €368 million was also raised through the Bank's new local currency borrowing programme.

In addition to medium to long-term debt, the caption "debts evidenced by certificates" includes short-term debt issuances that the Bank raises for cash management purposes.

Capital

Paid-in capital totalled €5.2 billion at 31 December 2006 and at 31 December 2005. The number of the EBRD's subscribed shares stood at almost 2 million. Paid-in capital receivable has been stated at its present value on the balance sheet to reflect future receipt by instalments.

The amount of overdue cash and promissory notes to be deposited totalled €19 million at the end of 2006 (2005: €24 million). A further €10 million of encashments of deposited promissory notes was also overdue (2005: €13 million).

Expenses

The Bank continues to focus on budgetary discipline, effective cost controls and a proactive cost-recovery programme. The EBRD's general administrative expenses, including depreciation and amortisation, were €225 million (2005: €219 million). A sterling/euro hedging programme for budget expenditure resulted in hedging gains of €1 million (2005: €8 million).

Provisions

The EBRD's portfolio provisioning relating to the unidentified impairment of loan investments on non-sovereign exposures is based on a risk-rated approach and is assessed monthly. A separate methodology is applied for all sovereign loan investments, which takes into account the Bank's preferred creditor

status afforded by its members. The Bank recognises specific provisions for the identified impairment of loans as required, after careful consideration on a case-by-case basis. Provisions are based on outstanding net disbursements at the relevant reporting date.

In 2005 the Bank established a loan loss reserve to set aside an amount of retained earnings within members' equity. This amount is equal to the difference between the impairment losses expected over the full life of the loan portfolio and the cumulative amount provisioned through the Bank's income statement on an incurred loss basis.

The 2006 charge for provisions on Banking loan investments, calculated on an incurred loss basis, was €53 million (2005: release of €197 million). This was split between portfolio provisions for the unidentified impairment of loan investments, which totalled €52 million compared with a release of €184 million in 2005, and specific provisions for the identified impairment of loan investments, which amounted to a net charge of €1 million in 2006 compared with a net credit of €13 million in 2005. The Bank revised its provisioning model in 2005 resulting in a net decrease in portfolio provisions of €186 million in that year.

Total provisions for Banking loan operations stood at €341 million at the end of 2006 (2005: €323 million). This represented 0.7 per cent of sovereign loans (2005: 0.7 per cent) and 4.8 per cent of non-sovereign loans (2005: 5.3 per cent).

In response to amendments in International Financial Reporting Standards (IFRS), from 1 January 2006 the Bank has adopted a new approach to accounting for financial guarantees that requires these investments to be reported at fair value (less cumulative amortisation) or, for impaired guarantees, at the appropriate specific provision level. As a result of the fair value approach to reporting guarantees, general portfolio provisions for guarantees are no longer required. This policy change led to a release of the opening provisioning balance at 1 January 2005 of €32 million and a decrease in guarantee provisions of €4 million in 2005. The 2005 comparatives have been restated to reflect these changes. The resultant fair value of the financial guarantees recognised in the balance sheet at 31 December 2006 was €5 million (2005 restated: €5 million).

Outlook for 2007

The EBRD has budgeted for a solid profit in 2007. However, the Bank's results remain vulnerable to changes in the economic environment and in financial markets, with the timing of equity exits and the volatility of local equity markets having particular influence on the Bank's profits.

Additional reporting and disclosures

The EBRD follows the significant reporting conventions of private sector financial institutions. A separate section of this Financial Report relating to risk management disclosures is an integral part of the financial statements and includes commentary on credit and market risk.

Corporate governance

The EBRD is committed to the highest standards of corporate governance. Responsibilities and related controls throughout the Bank are properly defined and delineated. Transparency and accountability are integral elements of its corporate governance framework. This structure is further supported by a system of reporting, with information appropriately tailored for, and disseminated to, each level of responsibility within the EBRD, to enable the system of checks and balances on the Bank's activities to function effectively.

The EBRD's governing constitution is the Agreement Establishing the Bank ("the Agreement"), which states that the institution will have a Board of Governors, a Board of Directors, a President, Vice Presidents, officers and staff.

All the powers of the EBRD are vested in the Board of Governors, which represents the Bank's 63 shareholders. With the exception of certain reserved powers, the Board of Governors has delegated the exercise of its powers to the Board of Directors, while retaining overall authority.

Board of Directors and Board Committees

Subject to the Board of Governors' overall authority, the Board of Directors is responsible for the direction of the EBRD's general operations and policies. It exercises the powers expressly assigned to it by the Agreement and those powers delegated to it by the Board of Governors.

The Board of Directors has established three Board Committees to assist with its work:

- the Audit Committee;
- the Budget and Administrative Affairs Committee; and
- the Financial and Operations Policies Committee.

The composition of these committees during 2006 is detailed in the separate Review section of the Annual Report.

The President

The President is elected by the Board of Governors and is the legal representative of the EBRD. Under the direction of the Board of Directors, the President conducts the current business of the Bank.

Executive Committee

The Executive Committee is chaired by the President and is composed of the Vice Presidents and other members of the EBRD's senior management.

EBRD Codes of Conduct

At the Annual Meeting in May 2006, the Governors approved new Codes of Conduct for officials of the Board of Directors and for Bank personnel and experts that represent and articulate clearly the values, duties and obligations as well as the ethical standards that the Bank expects of its officials and staff. The Codes incorporate a robust enforcement mechanism and detailed procedures for investigating alleged transgressions of the rules of the Codes by Directors, the President and Vice Presidents. The new Codes also affirm the Bank's commitment to protect whistleblowers.

Compliance

The Bank has an independent Office of the Chief Compliance Officer ("OCCO"), which is headed by a Chief Compliance Officer ("CCO") reporting directly to the President, and annually or as necessary to the Audit Committee. The CCO is mandated to promote good governance and ethical behaviour throughout all of the Bank's activities in accordance with international best practices. The role of the CCO includes dealing with integrity due diligence issues, confidentiality, corporate governance, ethics, conflicts of interest, anti-money-laundering, counter-terrorist financing and the prevention of fraudulent and corrupt practices. The OCCO is responsible for investigating fraud, corruption and misconduct. It also trains and advises, as necessary, the Bank's nominee directors who are appointed to companies in which the Bank holds an equity interest. Financial and integrity due

diligence is integrated into the Bank's normal approval of new business and the review of its existing transactions. The Bank publishes the CCO's anti-corruption report on its web site.

Moreover, the CCO has the specific responsibility for coordinating the Bank's Independent Recourse Mechanism ("IRM") that enhances the Bank's accountability by assessing and reviewing complaints about Bank-financed projects. The CCO can be dismissed by the President only in accordance with guidance given by the Board.

Operational risk

The EBRD defines operational risk as all aspects of risk-related exposure other than those falling within the scope of credit and market risk. This includes the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events and reputational risk. Risks include:

- errors or omissions in the processing and settlement of transactions, whether in the areas of execution, booking or settlement or due to inadequate legal documentation;
- errors in the reporting of financial results or failures in controls, such as unidentified limit excesses or unauthorised trading/trading outside policies;
- dependency on a limited number of key personnel, inadequate or insufficient staff training or skill levels;
- errors or failures in transaction support systems and inadequate disaster recovery planning, including errors in the mathematical formulae of pricing or hedging models, or in the computation of the fair value of transactions;
- external events; and
- damage to the EBRD's name and reputation, either directly by adverse comments or indirectly.

The EBRD has a low tolerance for material losses arising from operational risk exposures. Where material operational risks are identified (that is, those that may lead to material loss if not mitigated), appropriate mitigation and control measures are put in place after a careful weighing of the risk/return trade-off. Maintaining the EBRD's reputation is of paramount importance and reputational risk has therefore been included in the Bank's definition of operational risk. The EBRD will always try to take all reasonable and practical steps to safeguard its reputation.

Within the EBRD, there are policies and procedures in place covering all significant aspects of operational risk. These include first and foremost the EBRD's high standards of business ethics and its established system of internal controls, checks and balances and segregation of duties. These are supplemented with:

- the EBRD's Codes of Conduct;
- disaster recovery/contingency planning;
- the Public Information Policy;
- client and project integrity due diligence procedures, including anti-money-laundering measures;
- procedures for reporting and investigating suspected staff misconduct, including fraud;
- an information management policy; and
- procurement and purchasing policies, including the detection of corrupt practices in procurement.

Responsibility for developing the operational risk framework and for monitoring its implementation resides within the Risk Management Vice Presidency. The Committee of Sponsoring Organisations of the Treadway Commission (COSO) and Operational Risk Management unit is responsible for the overall framework and structure to support line managers who control and manage operational risk as part of their day-to-day activities. In addition, the unit coordinates the certification of internal controls over the financial reporting process. This allows extensive information on financial controls to be leveraged for operational risk management purposes, and for duplication between the two functions to be minimised. The unit also drafts proposals for discussion and review to the Operational Risk Management Group (ORMG), which implements the operational risk management policies and techniques throughout the Bank.

The ORMG is chaired by the Vice President, Risk Management and its membership comprises senior managers across the EBRD who have been identified as potentially facing the most operational risk within their day-to-day activities. The ORMG's task is to develop and coordinate the EBRD's approach to managing operational risk, and to ensure that it is widely implemented across all areas of the EBRD.

The EBRD's current operational risk framework includes: an agreed definition (see page 11), the categorisation of different loss type events to capture the EBRD's exposure to operational risk, a group of key risk indicators to measure such risks and the identification of specific operational risks through an annual self-assessment exercise. Departments within the EBRD identify their operational risk exposures and evaluate the mitigating controls that help to reduce the inherent or pre-control risk. Each risk (both inherent and post-control) is assessed for its impact, according to a defined value scale and the likelihood of occurrence, based on a frequency-by-time range. Following the conclusion of the self-assessment exercise, a series of challenge meetings based on product or risk type lines and across departments are held to validate the results and to increase consistency between departments.

Another important element of the EBRD's operational risk management framework is loss data – both internal and external. The EBRD collects internal operational risk incident data as reported by business units primarily to improve the control environment by taking into account the cost of control strengthening and perceived potential future losses. During 2006 the EBRD joined the external loss database GOLD where members "pool" operational risk incident information over a monetary threshold. This will provide the EBRD with access to information that goes beyond its own experience and supplements analysis undertaken on reported internal incidents. GOLD is run as an unincorporated not-for-profit consortium of financial services institutions.

Reporting

The EBRD's corporate governance structure is supported by appropriate financial and management reporting. The Bank has a mechanism that allows it to certify in the Annual Report: Financial Report as to the effectiveness of internal controls over external financial reporting, using the COSO internal control framework. This annual certification statement is signed by the President and Vice President, Finance and is subject to a review and an attestation by the Bank's external auditors. In addition, the Bank has a comprehensive system of reporting to the Board of Directors and its committees. This includes reporting of the activities of the Evaluation Department and Internal Audit to the Audit Committee.

External auditors

The external auditors are appointed by the Board, on the recommendation of the President, for a four-year term. No firm of auditors can serve for more than two consecutive four-year terms. The external auditors perform an annual audit to enable them to express an opinion on whether the financial statements present fairly the financial position and the profit of the Bank. They also examine whether the statements have been presented in accordance with IFRS and the overall principles of the EC Council Directive on Annual Accounts and Consolidated Accounts of Banks and other Financial Institutions. In addition, the external auditors review and offer their opinion on management's assertion as to the effectiveness of internal controls over financial reporting. This opinion is given as a separate report to the audit opinion. At the conclusion of their annual audit, the external auditors prepare a management letter for the Board of Directors, which is reviewed in detail and discussed with the Audit Committee, setting out the external auditors' views and management's responses on the effectiveness and efficiency of internal controls and other matters. The performance and independence of the external auditors is subject to annual review by the Audit Committee.

There are key provisions of the Bank's policy regarding the independence of the external auditors. The external auditors are prohibited from providing non-audit related services, subject to certain exceptions if it is judged to be in the interest of the Bank and if it is approved by the Audit Committee. However, the external auditors can provide technical cooperation consultancy services relating to client projects.

In 2006 the Bank reappointed PricewaterhouseCoopers LLP for a second four-year term covering 2007 to 2010.

Compensation policy

The EBRD has designed a market-oriented staff compensation policy, within the constraints of the Bank's status as a multilateral institution, to meet the following objectives:

- to be competitive in order to attract and retain high-calibre employees;
- to take account of differing levels of responsibility;
- to be sufficiently flexible to respond rapidly to the market; and
- to motivate and encourage excellent performance.

To help meet these objectives, the EBRD's shareholders have agreed that the Bank should use market comparators to evaluate its staff compensation and that salary and bonus should be driven by performance.

The bonus programme allocations are structured to recognise individual and team contributions to the EBRD's overall performance. Bonus payments, although an important element of the total staff compensation package, represent a limited percentage of base salaries.

EBRD personnel remuneration

All personnel on fixed-term or regular contracts receive a salary. In addition, professional members of staff are eligible to receive bonus awards depending on individual performance.

All fixed-term and regular employees – as well as the Board of Directors, the President and Vice Presidents – are covered by medical insurance, participate in the Bank's retirement scheme and may be eligible to receive a mortgage subsidy. Professional staff who join Headquarters from outside the United Kingdom may receive allowances to assist with relocation, as well as an accommodation allowance that can be used either to defray the cost of renting or purchasing accommodation. Professional staff hired from abroad, and who are not British citizens, are eligible for an education allowance.

The salaries and emoluments of all personnel are subject to an internal tax, applied at rates that vary according to the individual's salary and personal circumstances. Since personnel are subject to this internal tax, their salaries and emoluments are exempt from national income tax in the United Kingdom.

President and Vice Presidents

The President is elected by the Board of Governors and typically receives a fixed-term contract of four years. His salary and benefits are approved by the Governors. The President is not eligible for bonus awards.

The Vice Presidents are appointed by the Board of Directors on the recommendation of the President and typically have fixed-term contracts of four years. Their salaries and benefits are approved by the Board of Directors. The Vice Presidents are not eligible for bonus awards.

The gross salary, from which internal tax is deducted, for each of these positions as of December 2006 is as follows:

	€ 000
President	422
First Vice President, Banking	374
Vice President, Finance	341
Vice President, Risk Management	341
Vice President, Human Resources and Administration	312

Board of Directors

Directors are elected by the Board of Governors and typically serve a term of three years. Directors appoint Alternate Directors. The salaries of Directors and Alternate Directors are approved by the Board of Governors. They can participate in the same benefit scheme as staff but are not eligible for bonus awards.

The most recently approved gross salaries, from which internal tax is deducted, for these positions are as follows:

	€ 000
Director	179
Alternate Director	148

Senior management

Senior management comprises members of the Bank's Executive Committee, as well as: Business Group Directors; Corporate Directors; the Treasurer; the Director, Risk Management; the Controller; the Director, Human Resources; the Head of Internal Audit; and the Chief Compliance Officer. This group, excluding the President and Vice Presidents, consists of 17 individuals who received gross salaries, from which internal tax is deducted, in the range of €156,000 to €248,000 with an average bonus of 32 per cent in 2006.

Financial statements

These financial statements have been approved for issue by the Board of Directors on 6 March 2007.

Income statement

For the year ended 31 December 2006		Year to 31 December 2006 € million	Restated Year to 31 December 2005 € million
	Note		
Interest and similar income			
From loans		515	417
From fixed-income debt securities and other interest		550	363
Interest expenses and similar charges		(603)	(410)
Net interest income		462	370
Net fee and commission income	3	15	19
Dividend income		87	98
Net gains from share investments at fair value through profit or loss	4	898	489
Net gains from available-for-sale share investments	5	1,195	553
Net gains from available-for-sale Treasury assets	6	16	10
Net gains/(losses) from dealing activities and foreign exchange	7	8	(1)
Fair value movement on non-qualifying hedges	8	(14)	6
Operating income		2,667	1,544
General administrative expenses	9	(212)	(202)
Depreciation and amortisation	15, 16	(13)	(17)
Operating profit before provisions		2,442	1,325
Provisions for impairment of loan investments	10	(53)	197
Net profit for the year		2,389	1,522

The notes on pages 18 to 52 are an integral part of these financial statements.

Balance sheet

At 31 December 2006			31 December 2006		Restated 31 December 2005
	Note	€ million	€ million	€ million	€ million
Assets					
Placements with and advances to credit institutions		3,135		3,800	
Collateralised placements		2,573		1,475	
		5,708		5,275	
Debt securities	11				
Trading		1,764		710	
Available-for-sale		6,831		6,908	
		8,595		7,618	
			14,303		12,893
Other assets	12				
Derivative financial instruments		2,130		2,318	
Other		994		1,143	
			3,124		3,461
Loan investments	13				
Loans		8,311		7,819	
Less: Provisions for impairment	10	(341)		(323)	
		7,970		7,496	
Share investments	14				
Share investments at fair value through profit or loss		2,400		1,550	
Available-for-sale share investments		2,653		2,629	
		5,053		4,179	
			13,023		11,675
Intangible assets	15		21		16
Property, technology and office equipment	16		28		12
Paid-in capital receivable	19		192		327
Total assets			30,691		28,384
Liabilities					
Borrowings					
Amounts owed to credit institutions		1,194		978	
Debts evidenced by certificates	17	15,622		15,930	
			16,816		16,908
Other liabilities	18				
Derivative financial instruments		506		356	
Other		1,197		1,239	
			1,703		1,595
Total liabilities			18,519		18,503
Members' equity					
Subscribed capital	19	19,794		19,790	
Callable capital	19	(14,596)		(14,593)	
Paid-in capital			5,198		5,197
Reserves and retained earnings	20		6,974		4,684
Total members' equity			12,172		9,881
Total liabilities and members' equity			30,691		28,384
Memorandum items					
Undrawn commitments			6,769		6,679

The notes on pages 18 to 52 are an integral part of these financial statements.

Statement of changes in members' equity

	Subscribed capital € million	Callable capital € million	Special reserve € million	Loan loss reserve € million	General reserve other reserves € million	General reserve retained earnings € million	Total reserves and retained earnings € million	Total members' equity € million
For the year ended 31 December 2006								
At 31 December 2004	19,790	(14,593)	174	–	802	710	1,686	6,883
Transitional restatement of opening balance for fair value of financial assets at fair value through profit or loss (refer accounting policies note B)	–	–	–	–	–	(85)	(85)	(85)
At 1 January 2005 as restated in prior period	19,790	(14,593)	174	–	802	625	1,601	6,798
Transitional revaluation of opening balance for fair value of available-for-sale share investments (refer accounting policies note B)	–	–	–	–	330	–	330	330
Transitional revaluation of opening balance for fair value of equity derivatives (refer accounting policies note B)	–	–	–	–	–	43	43	43
At 1 January 2005 as revalued in prior period	19,790	(14,593)	174	–	1,132	668	1,974	7,171
Prior year restatement for changes in accounting policies (refer accounting policies note B)	–	–	–	–	–	32	32	32
At 1 January 2005 as restated	19,790	(14,593)	174	–	1,132	700	2,006	7,203
Internal tax for the year	–	–	–	–	4	–	4	4
Qualifying fees and commissions	–	–	14	–	–	(14)	–	–
Net fair value movement of available-for-sale investments for the year	–	–	–	–	1,152	–	1,152	1,152
Reserves transfer	–	–	–	292	8	(300)	–	–
Restated net profit for the year	–	–	–	–	–	1,522	1,522	1,522
At 31 December 2005 as restated	19,790	(14,593)	188	292	2,296	1,908	4,684	9,881
Internal tax for the year	–	–	–	–	4	–	4	4
Qualifying fees and commissions	–	–	27	–	–	(27)	–	–
Net fair value movement of available-for-sale investments for the year	–	–	–	–	(103)	–	(103)	(103)
Capital subscription	4	(3)	–	–	–	–	–	1
Reserves transfer	–	–	–	1	7	(8)	–	–
Net profit for the year	–	–	–	–	–	2,389	2,389	2,389
At 31 December 2006	19,794	(14,596)	215	293	2,204	4,262	6,974	12,172

The notes on pages 18 to 52 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2006	Year to 31 December 2006		Restated Year to 31 December 2005	
	€ million	€ million	€ million	€ million
Cash flows from operating activities				
Operating profit for the period ¹	2,389		1,522	
Adjustments for:				
Unwinding of the discount relating to impaired identified assets	–		(1)	
Interest income	(1,065)		(780)	
Interest expense and similar charges	603		410	
Fair value movement on capital receivable and associated hedges	(4)		(11)	
Net deferral and amortisation of fees and direct costs	27		20	
Internal taxation	4		4	
Realised gains on share investments	(1,337)		(640)	
Unrealised gains on share investments	(755)		(375)	
Impairment on share investments	(1)		(27)	
Unrealised gains on dealing securities	(58)		(2)	
Realised gains on available-for-sale securities	(6)		(3)	
Foreign exchange (gains)/losses	(1)		1	
Depreciation and amortisation	13		17	
Impairment recoveries on available-for-sale debt securities	(10)		(7)	
Gross provisions charge/(release) for loan losses	53		(197)	
	(148)		(69)	
Interest income received	1,034		746	
Interest expense and similar charges paid	(596)		(398)	
(Increase)/decrease in operating assets:				
Interest receivable and prepaid expenses	(5)		(2)	
Fair value movement	(95)		1,034	
Proceeds from repayments of loans	2,515		2,569	
Proceeds from prepayments of loans	730		784	
Funds advanced for loans	(4,204)		(3,008)	
Proceeds from sale of share investments	1,892		1,278	
Funds advanced for share investments	(806)		(379)	
Net placements to credit institutions	(1,142)		1	
(Decrease)/increase in operating liabilities:				
Interest payable and accrued expenses	11		10	
Net cash from operating activities		(814)		2,566
Cash flows from investing activities				
Proceeds from sale of available-for-sale securities	4,009		872	
Purchases of available-for-sale securities	(5,334)		(2,042)	
Purchase of property, technology and office equipment	(34)		(14)	
Net cash used in investing activities		(1,359)		(1,184)
Cash flows from financing activities				
Capital received	140		252	
Issue of debts evidenced by certificates	7,619		6,640	
Redemption of debts evidenced by certificates	(6,525)		(5,419)	
Net cash from financing activities		1,234		1,473
Net (decrease)/increase in cash and cash equivalents		(939)		2,855
Cash and cash equivalents at beginning of the period		4,277		1,422
Cash and cash equivalents at 31 December²		3,338		4,277

¹ Operating profit includes dividends of €87 million received for the year to 31 December 2006 (31 December 2005: €98 million).

² Cash and cash equivalents comprise the following amounts maturing within 3 months:

	2006 € million	2005 € million
Placements with and advances to credit institutions	3,115	3,768
Collateralised placements	1,403	1,475
Amounts owed to credit institutions	(1,180)	(966)
Cash and cash equivalents at 31 December	3,338	4,277

The notes on pages 18 to 52 are an integral part of these financial statements.

Accounting policies

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

A. Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB) and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions. The financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets, financial assets and financial liabilities held at fair value through profit or loss and all derivative contracts. In addition, financial assets and liabilities subject to amortised cost measurement, where they form part of a qualifying hedge relationship, have been accounted for in accordance with hedge accounting rules – see "Hedge accounting" under "Derivatives" on page 21.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Bank's policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the financial statements, are disclosed in "Critical accounting estimates and judgements" on page 22.

B. Significant changes in the financial statements

Amendments to published standards effective in 2006

IAS 19 (Amendment), Employee Benefits

This amendment introduces the option of an alternative recognition approach for actuarial gains and losses. It may impose additional recognition requirements for multi-employer plans where insufficient information is available to apply defined benefit accounting. It also adds new disclosure requirements.

As the Bank does not intend to change its accounting policy for recognising actuarial gains and losses and does not participate in any multi-employer plans, adopting this amendment has an impact only on the format and extent of disclosures presented in the financial statements.

IAS 39 (Amendment), The Fair Value Option

This amendment permits the irrevocable designation of financial instruments that meet certain conditions as ones to be measured at fair value through profit or loss. The conditions required to be met under the amendment are: where such designation eliminates or significantly reduces an accounting mismatch; when a group of financial assets, financial liabilities or both are managed and their performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy; and when an instrument contains an embedded derivative that meets particular conditions. From 1 January 2005, the Bank has designated its associate share investments and high-risk equity funds at fair value through profit and loss, as the performance of these assets is managed on a fair value basis in accordance with the Bank's risk management and accounting policies. The Bank has not taken the option to fair value liabilities.

IAS 39 and IFRS 4 (Amendment), Financial Guarantee Contracts

This amendment requires issued financial guarantees to be initially recognised at their fair value, and subsequently measured at the higher of the unamortised balance of the related fees received and deferred, or the expenditure required to settle the commitment at the balance sheet date. Prior to 2006, the Bank recognised that impairment on guarantees on a portfolio basis applied when the guarantees were effective and based on utilisation for trade finance. The Bank has retrospectively applied this amendment and the effect of the restatement was to decrease provisions for impairment in 2005 by €4 million, and to increase the Bank's opening retained earnings at 1 January 2005 by €32 million. As a result there was a reduction in balance sheet provisions of €28 million at 31 December 2005. This was partially offset by the recognition of unamortised fair value of €5 million, giving a net reduction to other liabilities at 31 December 2005 of €23 million. Other assets at that date increased by €5 million, representing guarantee fees receivable. The recognition of the present value of the fees receivable results in a negligible increase to interest income and therefore has no impact on the financial statements.

IFRIC 4, Determining whether an Arrangement contains a Lease

This interpretation provides guidance for determining whether certain arrangements are, or contain, leases that should be accounted for in accordance with IAS 17, Leases. The Bank has reviewed such arrangements in the context of this interpretation, and has concluded that adopting it would have no significant impact on the financial statements.

Standards early adopted by the Bank

No standards were early adopted by the Bank in 2006.

Standards, amendments and interpretations effective in 2006 but not relevant to the Bank's operations

The following new standards, amendments and interpretations to existing standards are mandatory for the Bank's 2006 financial statements but are not relevant to the Bank's operations:

- IAS 21 (Amendment), Net Investment in a Foreign Operation;
- IAS 39 (Amendment), Cash Flow Hedge Accounting for Forecast Intra-group Transactions;
- IFRS 1 (Amendment), First-Time Adoption of International Financial Reporting Standards;
- IFRS 6, Exploration for and Evaluation of Mineral Resources;
- IFRIC 5, Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds; and
- IFRIC 6, Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment.

Standards and interpretations to existing standards that are not yet effective and have not been early adopted by the Bank

The following published standards and interpretations to existing standards are mandatory for the Bank's accounting period beginning on 1 January 2007 or later periods, but have not been early adopted by the Bank:

IFRS 7, Financial Instruments: Disclosures, and the complementary Amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective for accounting periods from 1 January 2007)

IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments. This includes specified minimum disclosures about credit risk, liquidity risk and market risk, including an analysis of sensitivity to market risk. It replaces IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions, and the disclosure requirements in IAS 32, Financial Instruments: Disclosure and Presentation. IAS 1 (Amendment) introduces disclosures about the level of an entity's capital and how it manages that capital. The Bank has assessed the impact of IFRS 7 and IAS 1 (Amendment) and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by IAS 1 (Amendment). The Bank will apply IFRS 7 and IAS 1 (Amendment) from its annual period beginning 1 January 2007.

IFRS 8, Operating Segments (effective for accounting periods from 1 January 2009)

IFRS 8 requires an entity to report financial and descriptive information about its reportable segments. Reportable segments are operating segments, or aggregations of operating segments, that meet specified criteria. Operating segments are components of an entity about which separate financial information is available that is evaluated regularly by the chief operating decision maker when deciding how to allocate resources and in assessing performance. Financial information is required to be reported on the basis that it is used internally for evaluating operating segment performance and deciding how to allocate resources to operating segments. The Bank has assessed the impact of IFRS 8 and concluded that it is not expected to have an impact on the operating segments of the Bank, and that the main additional disclosures will be in relation to determining and measuring the Bank's operating segments. The Bank will apply IFRS 8 from its annual period beginning 1 January 2009.

IFRIC 9, Reassessment of Embedded Derivatives (effective for accounting periods from 1 June 2006)

An entity is required to assess whether an embedded derivative needs to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. IFRIC 9 concludes that reassessment is not permitted unless there is a significant change to the terms of the contract. The Bank will apply IFRIC 9 from 1 January 2007. It is not expected to have any impact on the Bank's financial statements as it is in line with the Bank's existing policies.

IFRIC 10, Interim Financial Reporting and Impairment (effective for accounting periods from 1 November 2006)

IFRIC 10 prohibits the impairment losses recognised in an interim period on goodwill, investments in equity instruments and investments in financial assets carried at cost to be reversed at a subsequent balance sheet date. The Bank will apply IFRIC 10 from 1 January 2007, but it is not expected to have any impact on the Bank's financial statements as it is in line with the Bank's existing policies.

Interpretations to existing standards that are not yet effective and not relevant to the Bank's operations

The following published interpretations to existing standards are mandatory for the Bank's accounting period beginning on 1 January 2007 or later periods, but are not relevant to the Bank's operations:

- IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies (effective for accounting periods from 1 March 2006);
- IFRIC 8, Scope of IFRS 2 (effective for accounting periods from 1 May 2006);
- IFRIC 11, IFRS 2 – Group and Treasury Share Transactions (effective for accounting periods from 1 March 2007); and
- IFRIC 12, Service Concession Arrangements (effective for accounting periods from 1 January 2008).

Changes in critical accounting policies, accounting estimates and judgements in the prior period

IAS 28 (Amendment), Investments in Associates

Prior to 2005, all associate share investments were accounted for as available-for-sale financial assets, as the Bank did not issue consolidated financial statements under the requirements of the previous IAS 28. As of 1 January 2005, the Bank applied the exemption for venture capital organisations under IAS 28 (Amendment). This permitted the Bank to designate share investments, previously held as available-for-sale and measured at cost less impairment, as financial assets at fair value through profit or loss. The Bank has chosen to designate all associate share investments and high-risk equity funds as financial assets at fair value through profit or loss with changes in fair value included in the income statement. All remaining non-associate share investments (excluding high-risk equity funds) continue to be designated as available-for-sale financial assets.

Prior to 2005, the Bank had concluded that it could not reliably measure the fair value of its unlisted share investments. It was therefore impracticable in the prior period to restate 2004 comparatives for unlisted associate share investments and high-risk equity funds. Following an enhancement of its valuation techniques, the Bank performed an assessment of the fair value of the unlisted share investment portfolio at 1 January 2005 and 31 December 2005 and restated its unlisted share investments to fair value. The effect of restating associate share investments and high-risk equity funds to fair value at 1 January 2005 was a decrease in the revaluation reserve of €85 million.

Fair valuation of unlisted share investments

Prior to 2005, the Bank valued its unlisted share investments at historic cost, less any provisions for impairment at the balance sheet date. Following an enhancement of its valuation techniques, the Bank performed an assessment of the fair value of the unlisted share investment portfolio as at 1 January 2005 and 31 December 2005 and revalued its unlisted share investments to fair value. As fair value could not be reliably measured prior to 2005, it was impracticable in the prior period to restate 2004 comparatives for unlisted share investments. The effect of revaluing unlisted non-associate share investments (excluding high risk equity funds) to fair value at 1 January 2005 was an increase in the revaluation reserve of €330 million.

Fair valuation of equity related derivatives

The enhancement of the Bank's valuation techniques in 2005 enabled the Bank to fair value its equity related derivatives. All derivatives are measured at fair value through the income statement in accordance with the "Derivatives" accounting policy explained on page 21. As fair value could not be reliably measured prior to 2005, it was impracticable in the prior period to restate the 2004 comparatives. An adjustment was made to opening retained earnings of €42 million to reflect the fair value of these derivatives at 1 January 2005.

C. Significant accounting policies

Financial assets

Loans and receivables

Loans and receivables originated by the Bank are measured at amortised cost using the effective yield method less any provision for impairment or uncollectability, unless they form part of a qualifying hedging relationship with a derivative position. This principally occurs in cases of fixed-rate loans that, through association with individual swaps, are transformed from a fixed-rate to a floating-rate basis. In such cases, the loan is re-measured to fair value in respect of interest rate risk. The change in value is then reported in the income statement as an offset to the change in value of the related swap. Loans are recognised at settlement date.

Collateralised placements are carried at amortised cost. These are structures wherein the risks and rewards associated with the ownership of a reference asset are transferred to another party through the use of a swap contract and are a form of collateralised lending.

Financial assets at fair value through profit or loss

This category includes the Bank's associate share investments and high-risk equity funds. Such assets are carried at fair value on the balance sheet with changes in fair value included in the income statement in the period in which they arise. The basis of fair value for listed financial assets at fair value through profit or loss in an active market is the quoted bid market price on the balance sheet date. The basis of fair value for financial assets at fair value through profit or loss that are either unlisted or listed in an inactive market is determined using valuation techniques appropriate to the market and industry of each investment. Purchases and sales of share investments are recorded at trade date. Share investments at fair value through profit or loss are analysed in note 14 (see page 43).

This category also includes assets acquired for the purpose of generating profits from short-term price fluctuations. Such assets are accounted for at fair value on the basis of independent market quotes, with all changes in value recorded through the income statement as they occur. Assets held in this category are accounted for at trade date.

Available-for-sale

This category comprises assets that do not specifically belong to one of the other categories. For the Bank, this consists of its non-associate share investments (excluding high-risk equity funds) and the majority of its Treasury portfolio. Such assets are carried at fair value on the balance sheet. Changes in fair value are recognised directly in reserves, as disclosed in the "Statement of changes in members' equity" on page 16, until the financial asset is sold or impaired. At this time the cumulative gain or loss previously recognised in reserves is removed and included in the income statement.

Share investments are impaired when there is objective evidence that the future recoverability is in doubt. This could be indicated by a significant or prolonged decline in the fair value of a share investment below its cost. The Bank also evaluates factors such as country, industry and sector performance, changes in technology and operational and financial performance. Impairment losses recognised in profit or loss for available-for-sale share investments are not reversed through the income statement.

Where an available-for-sale asset is the hedged item in a qualifying fair value hedge, the fair value gain or loss attributable to the risk being hedged is reported in the income statement rather than reserves. This is to ensure there is consistency of reporting, as the fair value changes on the derivative acting as the hedge must be reported in the income statement. Hedge accounting features in Treasury positions where asset swaps are used to transform the returns on fixed-interest-rate securities to a floating rate basis.

The basis of fair value for available-for-sale share investments listed in an active market is the quoted bid market price on the balance sheet date. The basis of fair value for available-for-sale share investments that are unlisted or listed in an inactive market is determined using valuation techniques appropriate to the market and industry of each investment. Purchases and sales of share investments are recorded at trade date. Available-for-sale share investments are analysed in note 14.

The fair value of available-for-sale assets in the Bank's Treasury portfolio is determined by bid quotes from third party sources or, where there is no active market, by the use of discounted cash flow models populated with observable market data. Purchases and sales of Treasury's available-for-sale assets are recorded at trade date.

Financial liabilities

Liabilities held for dealing

This occurs where the Bank has sold debt securities it does not yet own, known as "short" selling, with the intention of buying those securities more cheaply at a later date and thus generating a dealing profit. Such liabilities are measured at fair value with all changes in value reported in the income statement as they occur.

Other financial liabilities

With the exception of liabilities held for dealing, all other financial liabilities are measured at amortised cost, unless they form part of a qualifying hedge relationship with a derivative position.

Derivatives

All derivatives are measured at fair value through the income statement unless they form part of a qualifying cash flow hedging relationship. In this case, the fair value of the derivative is taken to reserves to the extent that it is a perfect hedge of the identified risk. Any hedge ineffectiveness will result in the relevant proportion of the fair value remaining in the income

statement. Fair values are derived primarily from discounted cash flow models, option-pricing models and from third party quotes. Derivatives are carried as assets when their fair value is positive, and as liabilities when their fair value is negative. All hedging activity is explicitly identified and documented by the Bank's Treasury department.

Hedge accounting

Hedge accounting is designed to bring accounting consistency to financial instruments that would not otherwise be permitted. A valid hedge relationship exists when a specific relationship can be identified between two or more financial instruments in which the change in value of one instrument (the hedge) is highly negatively correlated to the change in value of the other (the hedged item). To qualify for hedge accounting, this correlation must be within 80 to 125 per cent, with any ineffectiveness within these boundaries recognised in the income statement.

The Bank documents the relationship between hedging instruments and hedged items at the inception of the transaction. The Bank also documents its assessment, on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Fair value hedges

The Bank's hedging activities are primarily designed to mitigate interest rate risk by using swaps to convert fixed interest rate risk, on both assets and liabilities, into floating-rate risk. Such hedges are known as "fair value" hedges. Changes in the fair value of the effective portions of derivatives that are designated and qualify as fair value hedges, and that prove to be highly effective in relation to hedged risk, are included in the income statement, along with the corresponding change in fair value of the hedged asset or liability that is attributable to that specific hedged risk.

Cash flow hedges

The Bank has engaged in cash flow hedges, principally to minimise the exchange rate risk associated with the fact that its future administrative expenses are incurred in sterling. The amount and timing of such hedges fluctuate in line with the Bank's views on opportune moments to execute the hedges. The majority of any such hedging activity is for the following financial year but hedges beyond one year can be used. Hedging is mainly through the purchase of sterling in the forward foreign exchange market, but currency options can also be used. The movement in the fair value of cash flow hedges is recognised directly in reserves until such a time as the relevant expenditure is incurred. At 31 December 2006 the Bank had no cash flow hedges outstanding.

For further information on risk and related management policies, refer to the "Risk management policies" section on page 25.

Provisions for impairment of loan investments

Where there is objective evidence that an identified loan is impaired, specific provisions for impairment are recognised in the income statement. Impairment is defined as the difference between the carrying value of the asset and the net present value of expected future cash flows. It is determined using the instrument's original effective interest rate where applicable. Resulting adjustments include the unwinding of the discount in the income statement over the life of the asset, and any adjustments required in respect of a reassessment of the initial impairment.

Provisions for impairment of classes of similar assets that are not individually identified as impaired are calculated on a portfolio basis. The methodology used for assessing such impairment is based on a risk-rated approach for non-sovereign assets applied in the month of disbursement. A separate methodology is applied for all sovereign risk assets that takes into account the Bank's preferred creditor status afforded by its members. The effect of applying the Bank's methodology is considered to be equivalent to calculating impairment on an incurred loss basis, as it is the difference between the carrying value of the groups of similar assets and the net present value of their expected future cash flows. Impairment is deducted from the asset categories on the balance sheet.

Impairment, less any amounts reversed during the year, is charged to the income statement under the caption "Provisions for impairment of loan investments", as summarised in note 10 on page 41. When a loan is deemed uncollectable the principal is written off against the related estimated impairment. Subsequent recoveries are credited to the income statement if previously written off.

Financial guarantees

Issued financial guarantees are initially recognised at their fair value. They are subsequently measured at the higher of the unamortised balance of the related fees received and deferred, or the expenditure required to settle the commitment at the balance sheet date. The latter is determined after considering objective evidence that the guarantee is impaired, and is recognised when it is both probable that the guarantee will need to be settled, and that the settlement amount can be reliably estimated.

D. Critical accounting estimates and judgements

Estimates and judgements are continually evaluated. They are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Preparing financial statements in conformity with IFRS requires the Bank to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, and the reported amounts included in the income statement during the reporting period.

The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are as follows:

- fair value of available-for-sale share investments and financial assets at fair value through profit or loss; and
- provisions for impairment of loan investments.

These estimates are highly dependent on a number of variables that reflect the economic environment and financial markets of the Bank's countries of operations, but that are not directly correlated to market risks such as interest rate and foreign exchange risk. The resultant volatility, combined with a lack of comparable information in relation to the EBRD's Banking portfolio, limits the Bank's ability to apply traditional sensitivity analysis methods.

The methodology and assumptions used for estimating provisions for the impairment of loan investments are reviewed regularly to reduce any differences between loss estimates and actual experience.

E. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months maturity from the date of acquisition. The cash and cash equivalents are available for use at short notice and are subject to insignificant risk of changes in value, less liabilities on demand.

F. Foreign currencies

In accordance with Article 35 of the Agreement, the Bank originally used the European Currency Unit (ECU) as the reporting currency for the presentation of its financial statements. Following the replacement of the ECU with the euro (€) from 1 January 1999, the reporting currency for the Bank's presentation of its financial statements became the euro.

Foreign currency transactions are initially translated into euro using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions, and from the translation at the year-end exchange rate of monetary assets and liabilities denominated in foreign currencies, are included in the income statement, except when deferred in reserves as qualifying cash flow hedges. Translation differences on non-monetary items, such as share investments held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as share investments classified as available-for-sale financial assets, are included in the fair value reserve in equity.

G. Capital subscriptions

The Bank's share capital is denominated in euro. However, in addition to settling their capital obligations in euro, members are also entitled to settle in US dollars or Japanese yen. For this purpose, a fixed exchange rate for each currency was defined in Article 6 of the Agreement and these fixed exchange rates are used to measure the value of the associated capital, as reported in "members' equity" in the balance sheet. The corresponding figure for capital receivable on the asset side of the balance sheet is, however, measured at current exchange rates and discounted to its present value.

In order to ensure that capital receipts due in US dollars or Japanese yen retain, at a minimum, their value as determined by the Agreement's fixed rates, the Bank's policy is to fix their euro value through foreign exchange contracts. These derivatives are fair valued in accordance with IAS 39, with any gain or loss being recorded in the income statement.

H. Intangible assets

Costs associated with maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with identifiable and unique software products controlled by the Bank, and that will generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include the staff costs of the software development team and an appropriate portion of relevant overheads.

Expenditure that enhances or extends the performance of computer software programmes beyond their original specifications is recognised as a capital improvement and added to the original cost of the software. Computer software development costs recognised as assets are amortised using the straight-line method over an estimated life of three years.

I. Property, technology and office equipment

Property, technology and office equipment is stated at cost less accumulated depreciation. Depreciation is calculated on the straight-line method to write off the cost of each asset to its residual value over the estimated life as follows:

Freehold property	30 years
Improvements on leases of less than 50 years unexpired	Unexpired periods
Technology and office equipment	Three years

J. Accounting for leases

Leases of assets under which all the risks and benefits of ownership are effectively retained by the lessor are classified as operating leases. The Bank has entered into such leases for most of its office accommodation, both in London and in the Bank's countries of operations. Payments made under operating leases are charged to the income statement on a straight-line basis over the period of the lease. When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which the termination takes place.

K. Interest, fees, commissions and dividends

Interest is recorded on an accruals basis using the effective yield method. Interest is recognised on impaired loans through unwinding the discount used in the present value calculations applied to expected future cash flows.

Front-end fees and commitment fees are deferred in accordance with IAS 18, together with the related direct costs of originating and maintaining the commitment. These are then recognised in interest income using the effective interest method over the period from disbursement to repayment of the related loan. If the commitment expires without the loan being drawn down, the fee is recognised as income on expiry.

Fees received in respect of services provided over a period of time are recognised as income as the services are provided. Other fees and commissions are classed as income when received. Issuance fees and redemption premiums or discounts are amortised over the period to maturity of the related borrowings on an effective yield basis.

Dividends relating to share investments are recognised when received.

L. Staff retirement plan

The Bank has a defined contribution scheme and a defined benefit scheme to provide retirement benefits to its staff. Under the defined contribution scheme, the Bank and staff contribute to provide a lump sum benefit. The defined benefit scheme is funded entirely by the Bank and benefits are based on years of service and a percentage of final gross base salary as defined in the scheme.

The asset in respect of the defined benefit scheme is the fair value of plan assets minus the present value of the defined benefit obligation at the balance sheet date, together with adjustments for unrecognised actuarial gains/losses and past service cost. Independent actuaries calculate the defined benefit obligation at least every three years by using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows (relating to service accrued to the balance sheet date) using the yields available on high-quality corporate bonds. For intermediate years, the defined benefit obligation is estimated using approximate actuarial roll-forward techniques that allow for additional benefit accrual, actual cash flows and changes in the underlying actuarial assumptions.

The Bank keeps all contributions to the schemes, and all other assets and income held for the purposes of the schemes, separately from all of its other assets. Actual contributions made to the defined contribution scheme are charged to the income statement and transferred to the scheme's independent custodians. The charge to the income statement in respect of the defined benefit scheme is based on the current service cost and other actuarial adjustments, as determined by qualified external actuaries. Also included in this charge are actuarial gains and losses in excess of a 10 per cent corridor that are amortised over the estimated average service life remaining of the Bank's employees. The 10 per cent corridor is the higher of 10 per cent of the defined benefit obligation or the fair value of assets. The actuaries also advise the Bank as to the necessary contributions to be made to the defined benefit scheme, which are then transferred to the scheme's independent custodians.

M. Taxation

In accordance with Article 53 of the Agreement, within the scope of its official activities, the Bank, its assets, property and income are exempt from all direct taxes and all taxes and duties levied upon goods and services acquired or imported, except for those parts of taxes or duties that represent charges for public utility services.

N. Government grants

Government grants relating to fixed asset expenditure considered as part of the initial establishment of the Bank are recognised in the income statement on a straight-line basis over the same period as that applied for depreciation purposes. Other grants are matched against the qualifying expenditure in the period in which it is incurred. The balance of grants received or receivable that has not been taken to the income statement is carried in the balance sheet as deferred income within "other liabilities".

O. Borrowings

Borrowings are recognised initially at fair value, defined as their issue proceeds, net of any transaction costs incurred. They are subsequently stated at amortised cost and any difference between net proceeds and the redemption value is recognised in the income statement over the period of the borrowings using the effective yield method. Where borrowings have associated derivatives and qualify for hedge accounting in line with IAS 39, the amortised cost value is adjusted by the fair value of the hedged risks.

P. Comparatives

Where necessary, comparative figures have been adjusted to conform to changes in presentation in the current year. Comparative figures have been restated where appropriate, as disclosed in "Significant changes in the financial statements" (see page 18).

Risk management policies

Principles of financial management and risk management

The financial policies require the EBRD to follow the guiding principles of sound financial management, building on the Agreement Establishing the Bank. They provide the financial framework within which the Bank is required to pursue its mandate.

The EBRD's financial management aims to:

- pursue financial viability;
- build up reserves and ensure sustainable profitability;
- follow market and performance orientation in all its activities;
- work within a comprehensive risk management framework; and
- ensure transparency and accountability at all levels and support effective corporate governance.

The EBRD's financial policies define the financial and risk parameters that apply to Banking and Treasury operations. These policies include: (i) provisioning; (ii) pricing; and (iii) liquidity.

- (i) The provisioning policy provides the basis to determine the amount of general portfolio provisions for loan investments and the principles for specific provisions to be applied to loan investments and financial guarantees. To provide a check on the appropriateness of the policy, total provisions are regularly reviewed against losses calculated by the use of the Bank's risk capital model. The provisioning policy is reviewed annually.
- (ii) Pricing policies determine the considerations and parameters used to price loans, guarantees and share investments.
- (iii) The liquidity policy determines the amount of liquid assets required by the Bank, as well as its medium-term borrowing requirement for the following financial year. The liquidity policy is reviewed annually.

Furthermore, the financial policies define capital utilisation and provide portfolio risk parameters for Banking operations, hedging policies, share investment valuation, exit procedures and strategies, underwriting, risk management and corporate governance policies. These policies are reviewed regularly in light of experience and external developments.

The financial policies require that the Board of Directors approves a Treasury and Treasury Risk Management Authority (T&TRMA), which defines the risk parameters to be observed by Treasury in managing its exposures. This document is updated

annually by the Finance and Risk Management Vice Presidencies and approved by the Board. It covers all aspects of Treasury where financial risks are incurred and also all aspects of Treasury Risk Management (TRM) in order to identify, measure, manage and mitigate the financial risks in Treasury. In addition, Treasury and TRM guidelines have been issued in respect of Treasury risk-taking and TRM processes and procedures.

The T&TRMA is the document by which the Board of Directors delegates authority to the Vice President, Finance, to manage and the Vice President, Risk Management, to identify, measure, monitor and mitigate the Bank's Treasury exposures. The two Vice Presidents jointly interpret the T&TRMA and notify the Board of Directors of any material interpretation. The Financial and Operations Policies Committee reviews the T&TRMA annually and its review is submitted to the Board for approval.

The Credit Process document describes the procedures for approval, management and review of Banking exposures. These are reviewed by the Bank's Audit Committee annually and submitted to the Board for approval.

The Risk Management Vice Presidency has overall responsibility for the independent identification, measurement, monitoring and mitigation of all risks incurred by the Bank in both its Banking and Treasury operations. The Vice President, Risk Management, is a member of the Bank's Executive Committee, as are the First Vice President, Banking, and the Vice President, Finance, to whom Treasury reports. The Vice President, Risk Management, has overall responsibility for formulating the Bank's risk management strategy for both Banking and Treasury functions. Risk Management seeks to ensure that any risks are correctly identified and appropriately managed and mitigated through comprehensive and rigorous processes that reflect best industry practice.

Banking risks are managed through the Operations Committee. In 2006, the membership comprised: the First Vice President, Banking; the Vice President, Finance; the Vice President, Risk Management; the Chief Economist; the General Counsel; the Director, Risk Management; and a Business Group Director. The Operations Committee meets weekly and is responsible for reviewing all Banking projects prior to their submission for Board approval. Projects are reviewed to ensure that they meet the Bank's criteria for sound banking, transition impact and additionality. The Committee operates within authority delegated by the Board to approve projects within Board-approved framework operations. The Committee is also responsible for overseeing Banking portfolio management, approving significant changes to existing operations and approving Risk Management's recommendations for provisions for the impairment of Banking assets.

Treasury risks are reviewed by the Treasury Exposure Committee (TEC), which meets monthly. The Committee members are: the Vice President, Finance; the Vice President, Risk Management; the Treasurer; the Director, Risk Management; the Deputy Treasurer; the Director, Treasury Risk Management; the Chief Economist; the General Counsel; the Deputy General Counsel; and the Business Group Director, Financial Institutions. The TEC is responsible for reviewing and monitoring the implementation of the T&TRMA and related guidelines. It assesses Treasury and TRM policy proposals for approval by the Board, and monitors and reviews the asset/liability profile and risk return trade-off in aggregate Treasury exposures. It also evaluates new product proposals for Treasury exposures. Provisions for the impairment of Treasury exposures are recommended by Risk Management, assessed by the TEC and approved by the Vice Presidents of Finance and Risk Management.

Use of derivatives

The EBRD's use of exchange-traded and over-the-counter (OTC) derivatives is primarily focused on hedging interest rate and foreign exchange risks arising from both its Banking and Treasury activities. Market views expressed through derivatives are also undertaken as part of Treasury's activities, while the transactions through which the Bank funds itself in the capital markets are typically swapped into floating-rate debt with derivatives. In addition, the Bank uses credit derivatives as an alternative to investments in specific securities or to hedge certain exposures.

The risks arising from derivative instruments are combined with those deriving from all other instruments dependent on the same underlying risk factors, and are subject to overall market and credit risk limits, as well as to stress tests. Additionally, special care is taken with those risks that are specific to the use of derivatives, through, for example, the monitoring of volatility risk for options, spread risk for swaps and basis risk for futures.

In order to control credit risk in OTC derivative transactions, the EBRD's policy is to approve ex-ante each counterparty individually and to review its creditworthiness and eligibility regularly. Overall limits are allocated to each eligible counterparty

in compliance with guidelines that set a maximum to the size and tenor of exposure, based on the counterparty's internal credit rating and outlook. For those counterparties, typically banks, that are deemed eligible for foreign exchange and OTC derivatives, a portion of the overall counterparty limit is allocated to these instruments. Utilisation of limits, whether overall counterparty limits or dedicated foreign exchange and OTC derivatives limits, is calculated using potential future exposure methodology. This is based on a Monte Carlo simulation-based model and is measured and monitored daily for all counterparties, independently from risk takers.

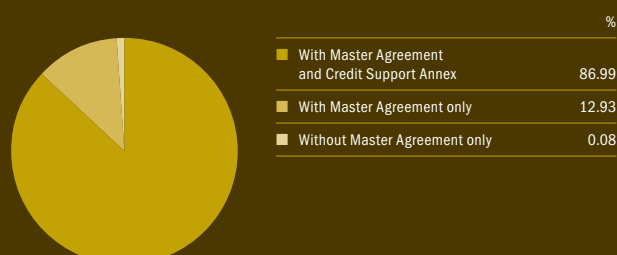
OTC derivative transactions are normally transacted only with the most creditworthy counterparties, rated at the internal equivalent of single-A and above. Furthermore, the EBRD pays great attention to mitigating the credit risk of OTC derivatives through the negotiation of appropriate legal documentation with counterparties. OTC derivatives transactions are systematically documented with a Master Agreement (MA) and a Credit Support Annex (CSA). These provide for close-out netting and the posting of collateral by the counterparty, once the Bank's exposure exceeds a given threshold, which is a function of the counterparty's perceived creditworthiness.

The Bank has also expanded the scope for applying risk mitigation techniques by documenting the widest possible range of instruments transacted with a given counterparty under a single MA and CSA, notably foreign exchange transactions. The Bank also systematically resorts to unwinding-upon-credit-downgrading clauses and, for long-dated transactions, unilateral break clauses. Similarly, the Bank emphasises risk mitigation for repurchase and reverse repurchase agreements and related transaction types through MA documentation.

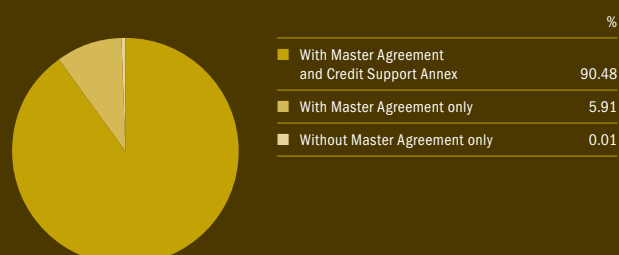
At 31 December 2006, 87.0 per cent of the Bank's gross exposure to derivatives counterparties was with counterparties with which an MA and CSA had been completed (2005: 90.5 per cent) (see charts below). All the Bank's exposure to foreign exchange and OTC derivatives was either with counterparties rated triple-A in their own right, or with counterparties with whom a collateral agreement had been completed, allowing for receipt of collateral in the form of cash or liquid, triple-A rated government securities.

OTC derivatives and foreign exchange exposure

31 December 2006



31 December 2005



The table below shows the nominal amounts of the Bank's derivative transactions outstanding at the end of 2006 and the associated fair values.

Derivative transactions

	2006 Nominal € million	2006 Fair value € million	2005 Nominal € million	2005 Fair value € million
Foreign currency products				
<i>OTC</i>				
Currency swaps	8,973	1,183	9,029	1,678
Spot and forward currency transactions	1,065	(20)	1,238	3
Total	10,038	1,163	10,267	1,681
Interest rate products				
<i>OTC</i>				
Interest-rate swaps	9,352	379	9,527	229
Forward rate agreements	116	–	81	–
Caps/floors	154	–	148	–
<i>Exchange-traded</i> ¹				
Interest-rate futures	3,132	–	3,352	–
Interest-rate options	299	–	28	–
Total	13,053	379	13,136	229
Credit products				
<i>OTC</i>				
Credit default swaps	2,849	(3)	1,562	1
Total	2,849	(3)	1,562	1
Banking products				
Equity derivatives	219	85	107	51
Total	219	85	107	51
Total OTC products	22,509	1,539	21,585	1,911
Total exchange-traded products	3,431	–	3,380	–
Total equity derivatives	219	85	107	51

¹ As exchange-traded instruments are cash-settled each day the related open fair values are negligible.

Credit exposure arises when the Bank has an overall positive fair value with individual counterparties. At 31 December 2006, the aggregate positive fair value amounted to €1.7 billion (2005: €2.0 billion). Against this, the Bank held collateral of €1.4 billion (2005: €1.7 billion), thereby reducing its net credit exposure to €0.3 billion (2005: €0.3 billion).

Financial risk factors

A. Credit risk

The EBRD is exposed to credit risk in both its Banking and Treasury activities. Credit risk arises because borrowers and Treasury counterparties could default on their contractual obligations, or the value of the Bank's investments could be impaired. Most of the EBRD's credit risk is in the Banking portfolio. Projects are reviewed regularly to identify promptly any changes required in the assigned risk ratings, and any actions required to mitigate increased risk. Exposures are measured against portfolio risk limits and reported to the Audit Committee quarterly.

Banking credit risk

The EBRD conducts regular reviews of individual exposures within its portfolio. Generally, projects are formally reviewed by Risk Management once or twice a year depending on risk, or more frequently for those that are perceived to be more vulnerable to possible default. Regular reviews continue after project completion for non-sovereign exposures. Each review includes a consideration of the project risk rating and, for equity investments, fair value. For underperforming projects, the review examines the level of impairment and corresponding specific provisions. Control of disbursement is managed by the Operation Administration Unit within the Office of the General Counsel, which is responsible for checking compliance with project conditionality prior to disbursement. The Unit also checks that correct procedures are followed in line with approved policy. The management of investments considered to be in jeopardy may be transferred from the Banking teams to the Corporate Recovery Unit, which reports jointly to Risk Management and Banking, in order to manage the restructuring work-out process.

All projects and countries of operations are assigned credit risk ratings on an internal scale from 1 (lowest risk) to 10 (highest risk). The Bank maintains three types of risk ratings: project, country and overall. The project rating is determined on the basis of the financial strength of the risk counterparty and the risk mitigation built into the project structure. The country rating is assessed internally, taking into consideration the ratings assessed by external rating agencies. For non-sovereign operations, the overall rating is the numerically higher of the project and country rating. The exception to this is where the Bank has recourse to unconditional sponsor support from outside the country of operations, in which case the overall rating is the same as the project rating. For sovereign risk projects, the overall rating is the same as the country rating. For the performing portfolio, portfolio provisions are established according to a matrix. This is designed to approximate incurred losses calculated on the basis of objective evidence of impairment, the Bank's experience, and project, sector and country risks.

The table below shows the distribution of Banking operating assets by country, instrument and sector.

Distribution of Banking operating assets, undrawn commitments and guarantees

<i>Analysis by country/region</i>	Operating assets 2006 € million	Operating assets 2005 € million	Undrawn commitments and guarantees 2006 € million	Undrawn commitments and guarantees 2005 € million
Albania	124	121	129	115
Armenia	47	33	17	11
Azerbaijan	88	162	306	240
Belarus	77	69	8	21
Bosnia and Herzegovina	164	149	297	241
Bulgaria	317	300	288	361
Croatia	1,157	781	169	123
Czech Republic	195	300	59	52
Estonia	58	59	–	–
FYR Macedonia	156	119	122	139
Georgia	115	90	70	47
Hungary	605	581	64	92
Kazakhstan	891	633	210	391
Kyrgyz Republic	39	78	14	5
Latvia	56	61	1	25
Lithuania	125	155	25	43
Moldova	49	62	14	25
Mongolia	2	–	2	–
Montenegro	20	17	13	21
Poland	1,111	1,108	397	390
Romania	1,446	1,951	711	716
Russian Federation	3,499	2,663	1,395	1,612
Serbia	582	295	426	384
Slovak Republic	238	305	57	60
Slovenia	214	207	5	33
Tajikistan	31	23	19	20
Turkmenistan	28	59	–	33
Ukraine	729	580	833	545
Uzbekistan	85	147	72	140
Regional	1,116	890	1,046	794
At 31 December	13,364	11,998	6,769	6,679

Analysis by instrument

Loans	8,145	7,751	5,287	5,370
Share investments at fair value	5,053	4,179	1,044	844
Debt securities	166	68	–	–
Trade finance guarantees ¹	–	–	293	317
Other guarantees ²	–	–	145	148
At 31 December	13,364	11,998	6,769	6,679

Analysis by sector

Commerce and tourism	488	383	157	252
Community and social services	264	266	348	153
Energy/power generation	1,052	755	983	1,192
Extractive industries	414	630	21	99
Finance	6,147	5,251	1,918	1,695
Local authority services	649	526	636	664
Manufacturing	1,748	1,605	524	522
Primary industries	364	363	272	206
Telecommunications	487	569	62	111
Transport and construction	1,751	1,650	1,848	1,785
At 31 December	13,364	11,998	6,769	6,679

¹ Trade finance guarantees represent standby letters of credit, issued in favour of confirming banks who undertake the payment risk of the issuing banks in the Bank's countries of operations.

² Other guarantees include unfunded full or partial risk participations.

Treasury credit risk

Credit risk is the potential loss to a portfolio that could result from the default of a counterparty or the deterioration of its creditworthiness, which could materialise in its downgrading by a rating agency, at any time until the maturity of the longest-dated transaction outstanding with that counterparty. More precisely, it can be referred to as pre-settlement risk. This is different from settlement risk, which occurs only at settlement, typically at the onset and at the maturity, when an exchange of cash or securities occurs in a transaction. As a special case, potential losses due to downgrading or, more generally, any change in the relative credit quality of securities are also often known as spread risk or credit spread risk. The Bank also monitors concentration risk, which is the risk arising from too high a proportion of the portfolio being allocated to a specific country, industry sector, obligor, type of instrument or individual transaction.

TRM assigns internal credit ratings, determined by referring to approved credit rating agencies and by using an internal assessment of the creditworthiness of counterparties. The internal credit rating scale ranges from 1 to 10, the same as that used for the Banking department's exposures. The Board-approved T&TRMA states the minimum rating and maximum tenor by type of eligible counterparty. The actual exposure size limit and/or tenor limit attributed to individual counterparties may be smaller or shorter, respectively, based on the likely direction of its credit quality over the medium term, its internal outlook, or on sector considerations. Individual counterparty lines for banks, corporates and insurance companies are measured, monitored and reviewed regularly by TRM.

The Bank's exposure measurement methodology for Treasury credit risk uses a Monte Carlo simulation technique that produces, to a high degree of confidence, maximum (in practice, 95 per cent eVaR¹⁰) exposure amounts at future points in time for each counterparty. This is across all transaction types and is measured out to the maturity of the longest-dated transaction with that counterparty.

Diversification by country/region

At 31 December 2006, Treasury credit risk exposure was allocated across 21 countries (see charts below). The top six countries (by percentage of the total exposure) were the United States of America (40.7 per cent), the United Kingdom (12.2 per cent), Spain (7.4 per cent), Belgium (6.9 per cent), France (4.4 per cent) and Japan (4.4 per cent).¹¹

Diversification by counterparty type

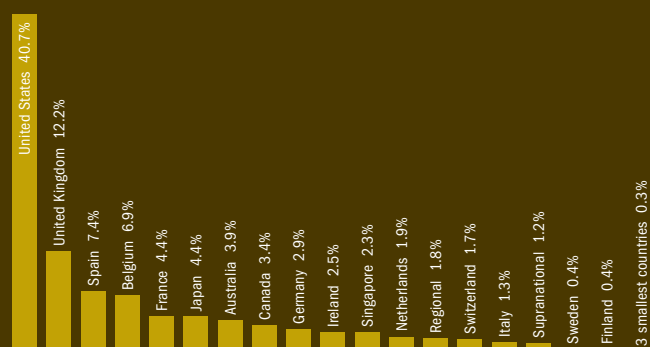
Over 50 per cent of the overall exposure was to banks (54.3 per cent, down from 61.1 per cent at the end of 2005), while exposure to sovereigns (14.2 per cent, up from 13.1 per cent at the end of 2005) and ABS (17.4 per cent, up from 11.3 per cent at the end of 2005), the next two largest obligor types, increased (see charts on page 31).

B. Market risk

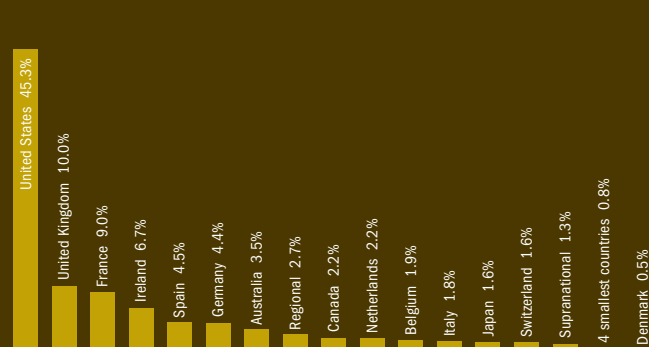
Market risk is the potential loss that could result from adverse market movements. The drivers of market risk are usually divided into: (i) interest rate risk; (ii) foreign exchange risk; (iii) equity risk; and (iv) commodity price risk. Interest rate risks are further broken down into yield curve risk, which measures the impact of changes in the shape of the yield curve for a given currency, and volatility risk, which deals with risks specific to interest rate option transactions. Yield curve risk can in turn be divided into changes in the overall level of interest rates (a parallel shift of an entire yield curve), and changes in the slope or the shape of the yield curve. Similarly, foreign exchange rate risks are split into risk emanating from changes in the level of foreign exchange rates, and volatility risk, which is inherent to foreign exchange options.

Diversification of Treasury peak exposure by country/region

31 December 2006



31 December 2005



The EBRD's main market risk exposure arises from the fact that movement of interest rates and foreign exchange rates may adversely affect positions taken by the Bank in its Treasury portfolio. The EBRD aims to limit and manage market risks as far as possible through active asset and liability management. Interest rate risks are managed by synthetically hedging the interest rate profiles of assets and liabilities, mainly through the use of exchange-traded and OTC derivatives for hedging purposes. Exposures to foreign exchange and interest rate risks are measured and monitored daily by TRM, independently of Treasury, to ensure compliance with authorised limits.

The Bank monitors its exposure to market risk in its Treasury portfolio through a combination of limits, based on Monte Carlo simulation-based eVaR, also known as Expected Shortfall, and a variety of additional risk measures. The Bank's overall eVaR limit is laid down in the Board-approved T&TRMA. Foreign exchange exposures are further constrained by a dedicated eVaR sub-limit.

Additional eVaR measures are monitored, in particular for drilling down from aggregate eVaR measures to individual market factors (marginal eVaR and VaR sensitivities). For the options portfolio, dedicated options eVaR computations are performed in order to factor in the non-linear behaviour of option instruments.

For internal monitoring purposes, eVaR is defined as the average potential loss that could be incurred due to adverse fluctuations in interest rates and foreign exchange rates over a one-day trading horizon and computed with a 95 per cent confidence level. Also, for enhanced comparability across institutions, numbers displayed in the Financial Report are VaR-based and scaled up to a 99 per cent confidence level over a 10-trading-day horizon.

A number of other risk measures are employed to complement eVaR and VaR data, with numbers produced using a different set of assumptions. This is to ensure that material risks are not ignored by focusing on one particular set of risk measures. Foreign exchange risk and the various types of interest rate risks, whether for outright exposures or for options, are monitored with sensitivity-based measures independently for each currency and type of option. A series of stress tests is also produced daily. These primarily encompass:

- (i) stress-testing the options portfolio for joint large changes in the level of the price of the underlying security and that of volatility;
- (ii) analysing, for each currency separately, the profit and loss impact of large deformations in the level and shape of the yield curve; and
- (iii) producing stress tests covering the entire Treasury portfolio based on historical scenarios.

¹⁰ VaR is a statistical estimate of the maximum probable loss that can be incurred, due to adverse movements in major market drivers, over a given time horizon and estimated at a given confidence level. Expected shortfall, or eVaR, is the average loss beyond the VaR level and is a more accurate measure of large potential losses.

¹¹ The top six countries at 31 December 2005 were the United States of America (45.3 per cent), the United Kingdom (10.0 per cent), France (9.0 per cent), Ireland (6.7 per cent), Spain (4.5 per cent), and Germany (4.4 per cent).

Exposure by counterparty type

31 December 2006



31 December 2005



C. Currency risk

Net currency position at 31 December 2006	Euro € million	United States dollars € million	Sterling € million	Japanese yen € million	Other currencies € million	Total € million
Assets						
Placements with and advances to credit institutions	887	2,044	131	32	41	3,135
Collateralised placements	1,160	1,413	–	–	–	2,573
Debt securities	4,544	3,105	484	203	259	8,595
Derivative financial instruments	378	(7,067)	2,704	2,127	3,988	2,130
Other assets	94	823	51	4	22	994
Loan investments	3,571	3,873	1	–	866	8,311
Provisions for impairment of loan investments	(126)	(199)	–	–	(16)	(341)
Share investments	5,053	–	–	–	–	5,053
Intangible assets	21	–	–	–	–	21
Property, technology and office equipment	28	–	–	–	–	28
Paid-in capital receivable	104	71	–	17	–	192
Total assets at 31 December 2006	15,714	4,063	3,371	2,383	5,160	30,691
Liabilities and members' equity						
Amounts owed to credit institutions	(996)	(34)	(4)	–	(160)	(1,194)
Debts evidenced by certificates	(1,780)	(3,741)	(3,009)	(2,346)	(4,746)	(15,622)
Derivative financial instruments	(662)	557	(188)	(18)	(195)	(506)
Other liabilities	(97)	(871)	(167)	(19)	(43)	(1,197)
Members' equity	(12,167)	(4)	–	–	(1)	(12,172)
Total liabilities and members' equity at 31 December 2006	(15,702)	(4,093)	(3,368)	(2,383)	(5,145)	(30,691)
Currency position at 31 December 2006	12	(30)	3	–	15	–

Restated						
Net currency position at 31 December 2005	Euro € million	United States dollars € million	Sterling € million	Japanese yen € million	Other currencies € million	Total € million
Assets						
Placements with and advances to credit institutions	1,254	2,414	13	43	76	3,800
Collateralised placements	901	574	–	–	–	1,475
Debt securities	2,983	3,658	641	235	101	7,618
Derivative financial instruments	68	(6,911)	2,876	2,512	3,773	2,318
Other assets	201	885	37	4	16	1,143
Loan investments	3,374	4,079	1	–	365	7,819
Provisions for impairment of loan investments	(122)	(180)	–	–	(21)	(323)
Share investments	4,179	–	–	–	–	4,179
Intangible assets	16	–	–	–	–	16
Property, technology and office equipment	12	–	–	–	–	12
Paid-in capital receivable	169	125	–	33	–	327
Total assets at 31 December 2005	13,035	4,644	3,568	2,827	4,310	28,384
Liabilities and members' equity						
Amounts owed to credit institutions	(844)	(61)	(4)	–	(69)	(978)
Debts evidenced by certificates	(1,773)	(4,344)	(2,925)	(2,773)	(4,115)	(15,930)
Derivative financial instruments	(413)	699	(511)	(34)	(97)	(356)
Other liabilities	(155)	(915)	(144)	(20)	(5)	(1,239)
Members' equity	(9,846)	(7)	–	–	(28)	(9,881)
Total liabilities and members' equity at 31 December 2005	(13,031)	(4,628)	(3,584)	(2,827)	(4,314)	(28,384)
Currency position at 31 December 2005	4	16	(16)	–	(4)	–

A derivative financial instrument has a single, overall fair value that determines whether it is reported as an asset or a liability on the Bank's balance sheet. However, the fair value of certain derivatives, notably cross-currency swaps, comprises a valuation in each of two underlying currencies, where one currency is an asset and the other currency a liability. In such cases, a currency representation of the balance sheet may unavoidably show a negative fair value component for an overall derivative asset or a positive fair value component for an overall derivative liability.

In addition to the Bank's reporting currency, the euro, currencies individually disclosed are those in which the Bank primarily raises funds (see note 17 on page 45) and which expose the Bank to exchange rate risk.

D. Interest rate risk

Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates. The length of time for which the rate of interest is fixed on a financial instrument indicates to what extent it is exposed to interest rate risk. The table below provides information on the extent of the Bank's interest rate exposure, based either on the contractual maturity date of its financial instruments or, in the case of instruments that reprice to a market rate of interest before maturity, the next repricing date. Securities that comprise the Bank's dealing portfolio are assumed to reprice within the "3 months to 1 year" category.

Repricing interval at 31 December 2006	Up to and including 1 month € million	Over 1 month and up to 3 months € million	Over 3 months and up to 1 year € million	Over 1 year and up to 5 years € million	Over 5 years € million	Non- interest- bearing funds € million	Total € million
Assets							
Placements with and advances to credit institutions	3,115	6	14	–	–	–	3,135
Collateralised placements	1,394	716	463	–	–	–	2,573
Debt securities	2,875	4,250	1,470	–	–	–	8,595
Derivative financial instruments	394	523	1,128	–	–	85	2,130
Other assets	53	43	740	–	–	158	994
Loan investments	1,346	2,784	3,884	126	150	21	8,311
Provisions for impairment of loan investments	–	–	–	–	–	(341)	(341)
Share investments	–	–	–	–	–	5,053	5,053
Intangible assets	–	–	–	–	–	21	21
Property, technology and office equipment	–	–	–	–	–	28	28
Paid-in capital receivable	–	–	–	–	–	192	192
Total assets	9,177	8,322	7,699	126	150	5,217	30,691
Liabilities and members' equity							
Amounts owed to credit institutions	(1,122)	(58)	(14)	–	–	–	(1,194)
Debts evidenced by certificates	(3,717)	(6,267)	(5,638)	–	–	–	(15,622)
Derivative financial instruments	(118)	(212)	(176)	–	–	–	(506)
Other liabilities	(33)	(63)	(956)	–	–	(145)	(1,197)
Members' equity	–	–	–	–	–	(12,172)	(12,172)
Total liabilities and members' equity	(4,990)	(6,600)	(6,784)	–	–	(12,317)	(30,691)
Interest rate risk at 31 December 2006	4,187	1,722	915	126	150	(7,100)	–
Cumulative interest rate risk at 31 December 2006	4,187	5,909	6,824	6,950	7,100	–	–

Restated
Repricing interval at 31 December 2005

	Up to and including 1 month € million	Over 1 month and up to and including 3 months € million	Over 3 months and up to and including 1 year € million	Over 1 year and up to and including 5 years € million	Non- interest- bearing funds € million	Total € million
Assets						
Placements with and advances to credit institutions	3,768	7	25	–	–	3,800
Collateralised placements	1,475	–	–	–	–	1,475
Debt securities	2,745	3,741	1,132	–	–	7,618
Derivative financial instruments	566	621	1,081	1	49	2,318
Other assets	108	38	983	–	14	1,143
Loan investments	1,102	2,851	3,770	60	36	7,819
Provisions for impairment of loan investments	(47)	(119)	(124)	–	(33)	(323)
Share investments	–	–	–	–	4,179	4,179
Intangible assets	–	–	–	–	16	16
Property, technology and office equipment	–	–	–	–	12	12
Paid-in capital receivable	–	–	–	–	327	327
Total assets	9,717	7,139	6,867	61	4,600	28,384
Liabilities and members' equity						
Amounts owed to credit institutions	(944)	(22)	(12)	–	–	(978)
Debts evidenced by certificates	(3,938)	(5,885)	(6,107)	–	–	(15,930)
Derivative financial instruments	(105)	(147)	(104)	–	–	(356)
Other liabilities	(5)	(128)	(1,106)	–	–	(1,239)
Members' equity	–	–	–	–	(9,881)	(9,881)
Total liabilities and members' equity	(4,992)	(6,182)	(7,329)	–	(9,881)	(28,384)
Interest rate risk at 31 December 2005	4,725	957	(462)	61	(5,281)	–
Cumulative interest rate risk at 31 December 2005	4,725	5,682	5,220	5,281	–	–

The Bank's interest rate risk measurement is complemented by accepted market techniques including VaR, spread risk and volatility risk, on which frequent management reporting takes place.

Effective interest rates

The table below gives average levels of interest rates applying at year-end on the Bank's interest-yielding assets and liabilities for the principal currencies in which the Bank operates. Trading securities are not included in this analysis, as the intention in holding such securities is not for generating net interest margins but rather capital gains from short-term price fluctuations.

	2006 EUR %	2006 US\$ %	2006 JPY %	2006 GBP %	2005 EUR %	2005 US\$ %	2005 JPY %	2005 GBP %
Assets								
Placements with and advances to credit institutions	3.61	5.33	0.38	5.19	2.39	4.35	–	4.75
Collateralised placements	3.98	5.64	–	–	2.86	4.91	–	–
Debt securities	3.92	5.71	0.68	6.94	2.69	4.87	0.23	5.67
Loans	5.40	7.40	–	7.43	4.31	7.14	–	6.54
Liabilities								
Amounts owed to credit institutions	(3.38)	(5.15)	–	(5.13)	(2.18)	(3.60)	–	(4.75)
Debts evidenced by certificates	(3.56)	(5.01)	(0.30)	(5.09)	(2.37)	(4.35)	0.23	(4.19)

E. Liquidity risk

Liquidity is the availability of sufficient funds to meet deposit withdrawals and other financial commitments as they fall due. The Bank is committed to maintaining a strong liquidity position. To ensure this, the Bank requires a minimum target liquidity ratio, based on a multi-year context, of 45 per cent of its next three years' net cash requirements, with full coverage of all committed but undisbursed project financing plus one year's debt service. In addition, 30 per cent of the Bank's net Treasury investments must mature within one year. This policy is implemented by maintaining liquidity in an operating target zone of 90 per cent of the next three years' net cash requirements and 100 per cent of committed but undisbursed project financing, plus one year's debt service. This is above the required minimum level.

The table below provides an analysis of assets, liabilities and members' equity placed into relevant maturity groupings, based on the remaining period from the balance sheet date to the contractual maturity date. It presents the most prudent maturity dates where options or repayment patterns allow for early repayment possibilities. Therefore, in the case of liabilities the earliest possible repayment date is shown, while for assets it is the latest possible repayment date. Assets held as part of Treasury's dealing portfolio are assigned a maturity of between 3 months and 1 year to reflect the typical holding pattern of assets in that portfolio.

Those assets and liabilities that do not have a contractual maturity date are grouped together in the "maturity undefined" category.

	Up to and including 1 month € million	Over 1 month and up to 3 months € million	Over 3 months and up to 1 year € million	Over 1 year and up to 5 years € million	Over 5 years € million	Maturity undefined € million	Total € million
Liquidity risk at 31 December 2006							
Assets							
Placements with and advances to credit institutions	3,115	–	14	6	–	–	3,135
Collateralised placements	1,203	200	–	192	978	–	2,573
Debt securities	97	122	838	2,906	4,632	–	8,595
Derivative financial instruments	88	162	258	280	1,257	85	2,130
Other assets	64	93	799	–	36	2	994
Loan investments	173	333	1,227	4,307	2,175	96	8,311
Provisions for impairment of loan investments	(14)	(12)	(47)	(173)	(75)	(20)	(341)
Share investments	–	–	–	–	–	5,053	5,053
Intangible assets	–	–	–	–	–	21	21
Property, technology and office equipment	–	–	–	–	–	28	28
Paid-in capital receivable	–	–	99	93	–	–	192
Total assets	4,726	898	3,188	7,611	9,003	5,265	30,691
Liabilities and members' equity							
Amounts owed to credit institutions	(1,122)	(58)	(14)	–	–	–	(1,194)
Debts evidenced by certificates	(894)	(1,399)	(2,485)	(3,580)	(7,264)	–	(15,622)
Derivative financial instruments	(96)	(166)	(156)	(43)	(45)	–	(506)
Other liabilities	(38)	(68)	(962)	–	–	(129)	(1,197)
Members' equity	–	–	–	–	–	(12,172)	(12,172)
Total liabilities and members' equity	(2,150)	(1,691)	(3,617)	(3,623)	(7,309)	(12,301)	(30,691)
Net liquidity position at 31 December 2006	2,576	(793)	(429)	3,988	1,694	(7,036)	–
Cumulative net liquidity position at 31 December 2006	2,576	1,783	1,354	5,342	7,036	–	–

Restated
Liquidity risk at 31 December 2005

	Up to and including 1 month € million	Over 1 month and up to and including 3 months € million	Over 3 months and up to and including 1 year € million	Over 1 year and up to and including 5 years € million	Over 5 years € million	Maturity undefined € million	Total € million
Assets							
Placements with and advances to credit institutions	3,768	–	25	7	–	–	3,800
Collateralised placements	1,475	–	–	–	–	–	1,475
Debt securities	16	76	947	2,924	3,655	–	7,618
Derivative financial instruments	112	155	272	377	1,402	–	2,318
Other assets	105	53	957	–	25	3	1,143
Loan investments	192	406	1,248	4,153	1,739	81	7,819
Provisions for impairment of loan investments	(11)	(14)	(38)	(183)	(48)	(29)	(323)
Share investments	–	–	–	–	–	4,179	4,179
Intangible assets	–	–	–	–	–	16	16
Property, technology and office equipment	–	–	–	–	–	12	12
Paid-in capital receivable	–	–	133	157	–	37	327
Total assets	5,657	676	3,544	7,435	6,773	4,299	28,384
Liabilities and members' equity							
Amounts owed to credit institutions	(944)	(22)	(12)	–	–	–	(978)
Debts evidenced by certificates	(912)	(771)	(2,635)	(3,729)	(7,883)	–	(15,930)
Derivative financial instruments	(73)	(110)	(107)	(36)	(30)	–	(356)
Other liabilities	(10)	(6)	(1,112)	–	–	(111)	(1,239)
Members' equity	–	–	–	–	–	(9,881)	(9,881)
Total liabilities and members' equity	(1,939)	(909)	(3,866)	(3,765)	(7,913)	(9,992)	(28,384)
Net liquidity position at 31 December 2005	3,718	(233)	(322)	3,670	(1,140)	(5,693)	–
Cumulative net liquidity position at 31 December 2005	3,718	3,485	3,163	6,833	5,693	–	–

Fair values of financial assets and liabilities

The Bank's balance sheet approximates to fair value in all financial asset and liability categories, with the exception of Banking fixed-rate loans where interest rate risk has been hedged on a portfolio basis. As a result, the Bank does not hedge account for such loans and therefore the underlying changes to the fair value of these assets are not recognised on the balance sheet. At 31 December 2006, the fair value of these loans was €12 million above the current balance sheet value (2005: €26 million above).

"Debt evidenced by certificates" represents the Bank's borrowing activities executed through the issuance of bonds and commercial paper. Due to the short-tenor nature of commercial paper, amortised cost is considered to equal fair value. Bonds are measured under hedge accounting rules due to their linkage with interest rate and currency swaps. The hedged values of the bonds are not traded in an open market. They are therefore valued through valuation techniques in which all observable market data that could influence the required valuations, namely benchmark interest rates (LIBOR or equivalent) and foreign currency exchange rates, has been incorporated. See note 17 (page 45) on "Debts evidenced by certificates" for information on the hedged fair value adjustment. The Bank considers that the fair value of its "debts evidenced by certificates" approximates to the reported hedged fair value as the Bank's credit rating has remained unchanged from the date of issuance of its bonds and therefore its borrowing credit spread has remained constant.

Notes to the financial statements

1. Establishment of the Bank

i Agreement Establishing the Bank

The European Bank for Reconstruction and Development ("the Bank"), whose principal office is located in London, is an international organisation formed under the Agreement Establishing the Bank dated 29 May 1990 ("the Agreement"). At 31 December 2006, the Bank's shareholders comprised 61 countries, together with the European Community and the European Investment Bank.

ii Headquarters Agreement

The status, privileges and immunities of the Bank and persons connected with the Bank in the United Kingdom are defined in the Headquarters Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Bank ("Headquarters Agreement"). The Headquarters Agreement was signed in London at the start of the Bank's operations on 15 April 1991.

2. Segment information

Business segments

For management purposes, the business of the Bank comprises primarily Banking and Treasury operations. Banking activities represent investments in projects which, in accordance with the Agreement, are made for the purpose of assisting the countries of operations in their transition to a market economy, while applying sound banking principles. The main investment products are loans, share investments and guarantees. Treasury activities include raising debt finance, investing surplus liquidity, managing the Bank's foreign exchange and interest rate risks and assisting clients in asset and liability management matters.

Primary reporting format – business segment

	Banking 2006 € million	Treasury 2006 € million	Aggregated 2006 € million	Restated Banking 2005 € million	Treasury 2005 € million	Aggregated 2005 € million
Interest income	515	545	1,060	417	352	769
Other income	2,195	24	2,219	1,159	9	1,168
Fair value movement on paid-in capital receivable and associated hedges ¹	5	–	5	10	1	11
Total segment revenue	2,715	569	3,284	1,586	362	1,948
Less interest expenses and similar charges ²	(370)	(485)	(855)	(259)	(303)	(562)
Allocation of the return on capital ^{1,2}	226	26	252	137	15	152
Fair value movement on non-qualifying hedges	–	(14)	(14)	–	6	6
Less general administrative expenses	(195)	(17)	(212)	(185)	(17)	(202)
Less depreciation and amortisation	(12)	(1)	(13)	(16)	(1)	(17)
Segment result before provisions	2,364	78	2,442	1,263	62	1,325
Provisions for impairment of loan investments	(53)	–	(53)	197	–	197
Net profit for the year	2,311	78	2,389	1,460	62	1,522
Segment assets	13,309	17,190	30,499	11,884	16,173	28,057
Paid-in capital receivable			192			327
Total assets			30,691			28,384
Segment liabilities						
Total liabilities	135	18,384	18,519	123	18,380	18,503
Capital expenditure	32	2	34	13	1	14

¹ Unwinding of interest income from the present value adjustment of paid-in capital receivable and the allocation of the return on capital total €257 million (2005: €163 million), which is the Bank's return on net paid-in capital used in segmental results.

² Interest expenses and similar charges and the allocation of the return on capital total €603 million (2005: €410 million). This is the Bank's "Interest expenses and similar charges", as reported in the income statement.

Secondary reporting format – geographical segment

The Bank's activities are divided into four regions for internal management purposes.

	Segment revenue 2006 € million	Restated Segment revenue 2005 € million	Segment assets 2006 € million	Restated Segment assets 2005 € million
Advanced countries ¹	837	923	4,359	4,549
Early/Intermediate countries ²	1,468	334	5,405	4,751
Russian Federation	410	329	3,545	2,584
OECD (Treasury operations)	569	362	17,190	16,173
Total	3,284	1,948	30,499	28,057

¹ Advanced countries are Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic and Slovenia.

² Early/Intermediate countries are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Former Yugoslav Republic of Macedonia, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Mongolia, Montenegro, Romania, Serbia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

3. Net fee and commission income

The main components of net fee and commission income are as follows:

	2006 € million	2005 € million
Trade finance fees	7	5
Appraisal fees	3	3
Repayment fees	3	2
Syndication fees	3	2
Cancellation fees	–	6
Other	1	4
Equity fund fee expenses	(2)	(3)
Net fee and commission income	15	19

Front-end and commitment fees of €43 million (2005: €38 million) received in 2006, together with related direct costs of €6 million (2005: €6 million), have been deferred on the balance sheet. They will be recognised in interest income over the period from disbursement to repayment of the related loan, in accordance with IAS 18. In 2006, €10 million (2005: €13 million) of previously deferred fees and direct costs were recognised in interest income.

4. Net gains from share investments at fair value through profit or loss

	2006 € million	2005 € million
Net unrealised gains from associate share investments and high-risk equity funds	731	366
Net realised gains from associate share investments and high-risk equity funds	143	114
Net unrealised gains from equity-related derivatives	23	9
Net realised gains from equity-related derivatives	1	–
Net gains from share investments at fair value through profit or loss	898	489

5. Net gains from available-for-sale share investments

	2006 € million	2005 € million
Net realised gains from available-for-sale share investments ¹	1,201	561
Impairment losses from available-for-sale share investments	(6)	(8)
Net gains from available-for-sale share investments	1,195	553

¹ This includes €7 million in relation to recoveries of previously recognised impairment losses (2005: €35 million). As impairment losses previously recognised in profit or loss for available-for-sale share investments cannot be reversed through the income statement, this represents realised amounts on subsequent exit/recovery.

6. Net gains from available-for-sale Treasury assets

	2006 € million	2005 € million
Realised gains from available-for-sale Treasury assets	6	3
Recoveries of previously recognised impairment losses on debt securities	14	7
Impairment losses from available-for-sale Treasury assets	(4)	–
Net gains from available-for-sale Treasury assets	16	10

7. Net gains/(losses) from dealing activities and foreign exchange

	2006 € million	2005 € million
Debt buy-backs	6	1
Foreign exchange	1	(1)
Dealing portfolio	1	(1)
Net gains/(losses) from dealing activities and foreign exchange	8	(1)

Net losses on the dealing portfolio include both realised and unrealised gains or losses, together with associated interest income and expense.

8. Fair value movement on non-qualifying hedges

The fair value movement on non-qualifying hedges does not derive from dealing activities but is a consequence of the accounting rules introduced by IAS 39. This accounting standard requires all derivatives to be fair valued in the income statement. Where derivatives are hedging non-derivative financial assets or liabilities, the latter can also be re-measured to fair value for the specific risks hedged and reported through the income statement. Hedge accounting, as this process is known, can only be used where hedge relationships can be specifically identified and close correlation proven. Interest rate hedging on a portfolio basis, which does not qualify for hedge accounting, is carried out against the Bank's fixed-rate loan book. Derivatives are used to exchange the fixed-rate flows on the loan assets in return for floating interest payments, primarily through the use of swap contracts. The swaps are subject to fair value accounting, but the fixed-rate loan assets are not. As the Bank is paying fixed rates of interest in these contracts, increases in the relevant interest rates, primarily the US dollar and the euro, will result in fair value gains on these contracts, while the converse will happen if rates fall. In 2006, both euro and US dollar rates rose, resulting in a net gain of €4 million for the year (2005: €5 million).

While hedge accounting can be applied to most of the Bank's derivative positions due to one-to-one hedging relationships, it is not possible to achieve 100 per cent hedge effectiveness where the change in value of the derivative is exactly matched by the change in value of the hedged asset or liability. Any ineffectiveness in the offsetting valuations must be recognised in the income statement. In 2006, this figure amounted to a loss of €18 million (2005: gain of €1 million).

9. General administrative expenses

	2006 € million	2005 € million
Personnel costs	141	146
Overhead expenses net of government grants	77	62
General administrative expenses	218	208
Deferral of direct costs related to loan origination and commitment maintenance	(6)	(6)
Net general administrative expenses	212	202

The average numbers of staff included in personnel costs during the year were: 995 headquarters staff (2005: 968), 247 locally hired staff in Resident Offices (2005: 235), 96 contract staff (comprising special contract staff, interns/short-term staff and locally hired general service contract staff), and 76 Board of Directors personnel. Some 75 staff members were externally funded.

Staff numbers at 31 December 2006 consisted of: 1,018 headquarters staff (comprising regular and analyst staff in Bank departments and Board support staff) (2005: 971), 261 locally hired staff in Resident Offices (2005: 232), 81 contract staff (comprising 16 special contract staff, 41 interns/short-term staff and 24 locally hired general service contract staff), and 75 Board of Directors personnel. Some 64 staff members were externally funded. In addition, 74 Project Bureau staff (2005: 90) were engaged by the Russia Small Business Fund on projects in the Russian Federation.

During the year, government grants of €1 million (2005: €2 million) were taken to the income statement.

The following fees for work performed by the Bank's external auditors were included in overhead expenses:

Audit and assurance services	2006 € 000	2005 € 000
Services as auditors of the Bank	260	275
Retirement plan audit	23	21
Internal controls framework assurance	134	127
Tax recovery audit	8	7
	425	430

Sterling general administrative expenses totalled £150 million (2005: £148 million).

Direct costs of €6 million (2005: €6 million) relating to loan origination and commitment maintenance in 2006, together with received front-end and commitment fees of €43 million (2005: €38 million), have been deferred on the balance sheet in accordance with IAS 18. These figures will be recognised in interest income over the period from disbursement to repayment of the related loan.

10. Provisions for impairment of loan investments

Charge/(release) for the year	2006 € million	2005 € million
Portfolio provisions for the unidentified impairment of loan investments:		
Non-sovereign loan investments	52	(135)
Sovereign loan investments	–	(49)
Specific provisions for the identified impairment of loan investments ¹	1	(13)
Provision for impairment of loan investments	53	(197)

¹ During the year new specific provisions for the identified impairment of loan investments of €13 million (2005: €22 million) were made and €12 million (2005: €35 million) were released. This resulted in a net charge to the income statement of €1 million (2005: release of €13 million).

Movement in provisions	2006 Loans € million	2005 Loans € million
At 1 January	323	508
Charge/(release) for the year	53	(197)
Unwinding of the discount relating to the impairment of identified assets	–	(1)
Foreign exchange adjustments	(20)	41
Release against amounts written off	(15)	(28)
At 31 December	341	323

Analysed between

Portfolio provisions for the unidentified impairment of loan investments		
Non-sovereign loan investments	309	274
Sovereign loan investments	14	15
Specific provisions for the identified impairment of loan investments	18	34
At 31 December	341	323

11. Debt securities

	2006 € million	2005 € million
Available-for-sale portfolio	6,831	6,908
Dealing portfolio		
Internally managed funds	1,159	144
Externally managed funds	605	566
At 31 December	8,595	7,618

12. Other assets

	2006 € million	Restated 2005 € million
Fair value of derivatives	2,130	2,368
Deals pending settlement	746	927
Interest receivable	187	157
Other	61	9
At 31 December	3,124	3,461

13. Loan investments

Operating assets	2006 Sovereign loans € million	2006 Non-sovereign loans € million	2006 Total loans € million	2005 Sovereign loans € million	2005 Non-sovereign loans € million	2005 Total loans € million
At 1 January	2,037	5,782	7,819	1,891	5,722	7,613
Movement in fair value revaluation	–	(6)	(6)	(1)	(6)	(7)
Disbursements	434	3,770	4,204	379	2,629	3,008
Repayments and prepayments	(358)	(2,887)	(3,245)	(414)	(2,939)	(3,353)
Foreign exchange movements	(129)	(284)	(413)	187	424	611
Movement in net deferral of front-end fees and related direct costs	(7)	(20)	(27)	(5)	(15)	(20)
Written off	–	(21)	(21)	–	(33)	(33)
At 31 December	1,977	6,334	8,311	2,037	5,782	7,819
Impairment at 31 December	(14)	(327)	(341)	(14)	(309)	(323)
Total operating assets net of impairment at 31 December	1,963	6,007	7,970	2,023	5,473	7,496

At 31 December 2006, the Bank categorised nine loans as impaired, with operating assets totalling €19 million (2005: 11 loans totalling €35 million). Specific provisions on these assets amounted to €18 million (2005: €34 million).

14. Share investments

	Fair value through profit or loss unlisted share investments € million	Fair value through profit or loss listed share investments € million	Fair value through profit or loss total share investments € million	Available-for-sale unlisted share investments € million	Available-for-sale listed share investments € million	Available-for-sale total share investments € million	Total share investments € million
Outstanding disbursements							
At 31 December 2004	–	114	114	1,887	430	2,317	2,431
Designated as fair value through profit or loss	1,096	–	1,096	(1,096)	–	(1,096)	–
At 1 January 2005 as restated	1,096	114	1,210	791	430	1,221	2,431
Transfer between classes	(10)	10	–	(110)	110	–	–
Disbursements	239	2	241	85	53	138	379
Disposals	(283)	–	(283)	(171)	(160)	(331)	(614)
Written off	(12)	–	(12)	(2)	(10)	(12)	(24)
At 31 December 2005	1,030	126	1,156	593	423	1,016	2,172
At 31 December 2005	1,030	126	1,156	593	423	1,016	2,172
Transfer between classes	2	–	2	(14)	12	(2)	–
Disbursements	228	123	351	327	128	455	806
Disposals	(197)	(9)	(206)	(247)	(74)	(321)	(527)
Written off	(28)	–	(28)	–	–	–	(28)
At 31 December 2006	1,035	240	1,275	659	489	1,148	2,423
Fair value adjustment							
At 31 December 2004	–	113	113	(510)	618	108	221
Transitional revaluation of opening balances to fair value	(85)	–	(85)	–	–	–	(85)
At 1 January 2005 as restated	(85)	113	28	(510)	618	108	136
Transitional restatement of opening balances to fair value	–	–	–	330	–	330	330
At 1 January 2005 as revalued	(85)	113	28	(180)	618	438	466
Movement in fair value revaluation	327	39	366	883	265	1,148	1,514
Impairment of available-for-sale share investments	–	–	–	1	26	27	27
At 31 December 2005	242	152	394	704	909	1,613	2,007
At 31 December 2005	242	152	394	704	909	1,613	2,007
Transfer between classes	(8)	8	–	–	–	–	–
Movement in fair value revaluation	324	407	731	(602)	493	(109)	622
Impairment of available-for-sale share investments	–	–	–	1	–	1	1
At 31 December 2006	558	567	1,125	103	1,402	1,505	2,630
Fair value at 31 December 2006	1,593	807	2,400	762	1,891	2,653	5,053
Fair value at 31 December 2005	1,272	278	1,550	1,297	1,332	2,629	4,179

At 31 December 2006, the Bank categorised 13 available-for-sale share investments as impaired, with outstanding disbursements totalling €79 million (2005: 18 available-for-sale share investments totalling €55 million).

Listed below are all share investments where the Bank owned greater than or equal to 20 per cent of the investee share capital at 31 December 2006 and where the fair value of the Bank's total investment exceeded €40 million.

	% Ownership
MPF Lafarge: Romcim	38
Connex	35
Dalkia Lodz Cogeneration Privatisation	35
Regional Europolis Portfolio	35
Winterthur MPF	35
Baring Vostok Private Equity Fund	32
Danone MPF – Danone Industria LLC	30
Komercijalna Banka	25
Sibacadembank Equity Investment	25
Polish Enterprise Fund V	25
Privredna Banka Zagreb	21

15. Intangible assets

	2006 Computer software development costs € million	2005 Computer software development costs € million
<i>Cost</i>		
At 1 January	63	55
Additions	13	8
At 31 December	76	63
<i>Amortisation</i>		
At 1 January	47	37
Charge	8	10
At 31 December	55	47
Net book value at 31 December	21	16

16. Property, technology and office equipment

	2006 Property € million	2006 Property under construction € million	2006 Technology and office equipment € million	2006 Total € million	2005 Property € million	2005 Property under construction € million	2005 Technology and office equipment € million	2005 Total € million
<i>Cost</i>								
At 1 January	64	4	35	103	64	–	33	97
Additions	–	19	2	21	–	4	2	6
Disposals	(56)	–	(11)	(67)	–	–	–	–
At 31 December	8	23	26	57	64	4	35	103
<i>Depreciation</i>								
At 1 January	59	–	32	91	54	–	30	84
Charge	3	–	2	5	5	–	2	7
Disposals	(56)	–	(11)	(67)	–	–	–	–
At 31 December	6	–	23	29	59	–	32	91
Net book value at 31 December	2	23	3	28	5	4	3	12

Property includes fixtures and fittings.

17. Debts evidenced by certificates

The Bank's outstanding debts evidenced by certificates and related fair value hedging swaps are summarised below:

	Principal at nominal value € million	Hedge accounting adjustment € million	Adjusted principal value € million	Currency swaps payable/ (receivable) € million	Net currency obligations 2006 € million	Net currency obligations 2005 € million
Australian dollars	858	219	1,077	(1,077)	–	–
Canadian dollars	33	7	40	(40)	–	–
Czech koruna	145	(44)	101	(101)	–	–
Euro	1,656	80	1,736	240	1,976	2,143
Hungarian forints	28	8	36	(34)	2	3
Japanese yen	2,377	(36)	2,341	(2,063)	278	286
Mexican peso	225	5	230	(230)	–	–
New Taiwan dollars	332	(7)	325	(325)	–	–
New Turkish lira	54	(1)	53	(53)	–	–
New Zealand dollars	1,228	(5)	1,223	(1,223)	–	–
Slovak koruna	18	7	25	(25)	–	–
South African rands	1,416	(223)	1,193	(1,193)	–	–
Sterling	2,782	516	3,298	(1,214)	2,084	1,834
Russian roubles	484	–	484	–	484	122
United States dollars	3,303	157	3,460	7,338	10,798	11,542
At 31 December	14,939	683	15,622	–	15,622	15,930

During the year the Bank redeemed €89 million of bonds and medium-term notes prior to maturity (2005: €55 million), generating a net gain of €6 million (2005: €1 million).

18. Other liabilities

	2006 € million	Restated 2005 € million
Fair value of derivatives	506	356
Treasury deals pending settlement	693	858
Interest payable	152	144
Other	352	237
At 31 December	1,703	1,595

19. Subscribed capital

	2006 Number of shares	2006 Total € million	2005 Number of shares	2005 Total € million
Authorised share capital	2,000,000	20,000	2,000,000	20,000
<i>of which</i>				
Subscriptions by members – initial capital	992,175	9,922	991,975	9,920
Subscriptions by members – capital increase	987,175	9,872	986,975	9,870
Subscribed capital	1,979,350	19,794	1,978,950	19,790
Unsubscribed capital	20,650	206	21,050	210
At 31 December	2,000,000	20,000	2,000,000	20,000

Capital adequacy

The Bank's original authorised share capital was €10.0 billion. Under Resolution No. 59, adopted on 15 April 1996, the Board of Governors approved a doubling of the Bank's authorised capital stock to €20.0 billion. This increase allowed the Bank to continue to implement its operational strategy on a sustainable basis.

The Bank's capital usage is guided by statutory and financial policy parameters. Article 12 of the Agreement Establishing the Bank limits the total amount of outstanding loans, share investments and guarantees made by the Bank in its countries of operations to the total amount of the Bank's unimpaired subscribed capital, reserves and surpluses, establishing a 1:1 gearing ratio. Article 12 also limits the total amount of disbursed share investments to the total amount of the Bank's unimpaired paid-in subscribed capital, surpluses and general reserve.

In accordance with the requirements of Article 5.3 of the Agreement, the Board of Governors shall review the capital stock of the Bank at intervals of not more than five years. In 2006 the Bank concluded a review of its capital stock as part of the Third Capital Resources Review (CRR3). This included an analysis of the transition impact and operational activity of the Bank, an assessment of the economic outlook and transition challenges in the region, the formulation of the medium-term portfolio development strategy and objectives, and a detailed analysis of the Bank's projected future financial performance and capital adequacy.

The traditional headroom measure of capital adequacy is being reviewed and supplemented with a risk-based analysis using both (i) regulatory capital guidelines of the Basel II Framework and (ii) a proxy for economic capital based on the Bank's risk capital model. The CRR3 analysis showed that the Bank should have sufficient capital to implement its operational strategy over the 2006-2010 period within the stated risk and financial assumptions. The review underlined that the Bank relies on a strong capital base and stressed the need for prudent financial policies that support conservative provisioning, strong liquidity and long term profitability. This is intended to enable the Bank to sustain its operational activity, taking account of significant medium term risks arising from its projects, from uncertainty in some sectors and countries of operations, and from the volatility of the financial markets.

The Bank's capital stock is divided into paid-in shares and callable shares. Each share has a par value of €10,000. Payment for the paid-in shares subscribed to by members is made over a period of years determined in advance. Article 6.4 of the Agreement states that payment of the amount subscribed to the callable capital is subject to call by the Bank, taking account of Articles 17 and 42 of the Agreement, only as and when required by the Bank to meet its liabilities. Article 42.1 states that in the event of the termination of the Bank's operations, the liability of all members for all uncalled subscriptions to the capital stock will continue until all claims of creditors, including all contingent claims, have been discharged.

The Agreement allows for a member to withdraw from the Bank, in which case the Bank is required to repurchase the former member's shares. No member has ever withdrawn its membership, nor has any indicated to the Bank that it is intending to do so. The stability in the membership reflects the fact that the members are 61 states and two inter-governmental organisations, and that the purpose of the Bank is to foster the transition process in politically qualifying countries in central and eastern Europe. Moreover, there is a financial disincentive to withdrawing membership. The upper limit of the amount of the repurchase price of the former member's shares is the amount of its paid-in capital, yet a former member remains liable for its direct obligations and its contingent liabilities to the Bank for as long as any part of the loans, equity investments or guarantees contracted before it ceased to be a member are outstanding. Were a member to withdraw from the Bank, the Bank would be able to impose conditions and set dates in respect of payments for shares repurchased. If, for example, paying a former member would have adverse consequences for the Bank's financial position, the Bank could defer payment until the risk had passed, and indefinitely if appropriate. If a payment was then made to a former member, the member would be required to repay, on demand, the amount by which the repurchase price would have been reduced if the losses for which the former member remained liable had been taken into account at the time of payment.

Under the Agreement, payment for the paid-in shares of the original capital stock subscribed to by members was made in five equal annual instalments. Of each instalment, up to 50 per cent was payable in non-negotiable, non-interest-bearing promissory notes or other obligations issued by the subscribing member and payable to the Bank at par value upon demand. Under Resolution No. 59, payment for the paid-in shares subscribed to by members under the capital increase is to be made in eight equal annual instalments. A member may pay up to 60 per cent of each instalment in non-negotiable, non-interest-bearing promissory notes or other obligations issued by the member and payable to the Bank at par value upon demand. The Board of Directors agreed a policy of encashment in three equal annual instalments for promissory notes relating to initial capital, and five equal annual instalments for promissory notes relating to the capital increase.

A statement of capital subscriptions showing the amount of paid-in and callable shares subscribed to by each member, together with the amount of unallocated shares and votes, is set out in the following table. Under Article 29 of the Agreement, the voting rights of members that have failed to pay any part of the amounts due in respect of their capital subscription are proportionately reduced until payment is made.

Summary of paid-in capital receivable	2006 € million	2005 € million
Paid-in subscribed capital:		
Promissory note encashments not yet due	163	290
Cash and promissory notes due but not yet received	19	24
Promissory note encashments due but not yet received	10	13
Paid-in capital receivable at 31 December	192	327

Paid-in capital receivable has been stated at its present value on the balance sheet to reflect future receipt by instalments.

19. Subscribed capital (continued)

Statement of capital subscriptions At 31 December 2006

	Total shares (number)	Resulting votes ¹ (number)	Total capital € million	Callable capital € million	Paid-in capital € million
Members					
Albania	2,000	1,557	20	15	5
Armenia	1,000	812	10	7	3
Australia	20,000	20,000	200	148	52
Austria	45,600	45,600	456	336	120
Azerbaijan	2,000	1,857	20	15	5
Belarus	4,000	4,000	40	30	10
Belgium	45,600	45,600	456	336	120
Bosnia and Herzegovina	3,380	3,380	33	25	8
Bulgaria	15,800	15,800	158	116	42
Canada	68,000	68,000	680	501	179
Croatia	7,292	7,292	72	54	18
Cyprus	2,000	2,000	20	15	5
Czech Republic	17,066	17,066	170	125	45
Denmark	24,000	24,000	240	177	63
Egypt	2,000	1,750	20	15	5
Estonia	2,000	2,000	20	15	5
European Community	60,000	60,000	600	442	158
European Investment Bank	60,000	60,000	600	442	158
Finland	25,000	25,000	250	184	66
Former Yugoslav Republic of Macedonia	1,382	1,382	14	10	4
France	170,350	170,350	1,704	1,257	447
Georgia	2,000	367	20	15	5
Germany	170,350	170,350	1,704	1,257	447
Greece	13,000	13,000	130	96	34
Hungary	15,800	15,207	158	116	42
Iceland	2,000	1,970	20	15	5
Ireland	6,000	6,000	60	44	16
Israel	13,000	13,000	130	96	34
Italy	170,350	169,684	1,704	1,257	447
Japan	170,350	170,350	1,704	1,257	447
Kazakhstan	4,600	4,600	46	34	12
Korea, Republic of	20,000	20,000	200	147	53
Kyrgyz Republic	2,000	667	20	15	5
Latvia	2,000	2,000	20	15	5
Liechtenstein	400	400	4	3	1
Lithuania	2,000	2,000	20	15	5
Luxembourg	4,000	3,850	40	29	11
Malta	200	200	2	1	1
Mexico	3,000	3,000	30	21	9
Moldova	2,000	1061	20	15	5
Mongolia	200	200	2	1	1
Montenegro ²	400	400	4	3	1
Morocco	1,000	1000	10	7	3
Netherlands	49,600	49,600	496	366	130
New Zealand	1,000	1,000	10	7	3
Norway	25,000	25,000	250	184	66
Poland	25,600	25,600	256	189	67
Portugal	8,400	8,400	84	62	22
Romania	9,600	9,600	96	71	25
Russian Federation	80,000	77,000	800	590	210
Serbia	9,350	8,719	94	69	25
Slovak Republic	8,534	8,534	85	63	22
Slovenia	4,196	4,196	42	31	11
Spain	68,000	68,000	680	501	179
Sweden	45,600	45,600	456	336	120
Switzerland	45,600	45,600	456	336	120
Tajikistan	2,000	261	20	15	5
Turkey	23,000	23,000	230	170	60
Turkmenistan	200	139	2	1	1
Ukraine	16,000	15,360	160	118	42
United Kingdom	170,350	170,350	1,704	1,257	447
United States of America	200,000	199,996	2,000	1,475	525
Uzbekistan	4,200	3,926	42	31	11
Capital subscribed by members	1,979,350	1,966,633	19,794	14,596	5,198

¹ Voting rights are restricted for non-payment of amounts due in respect of the member's obligations in relation to paid-in shares.
Total votes before restrictions amount to 1,979,350 (2005: 1,978,950).

² The Republic of Montenegro became a member of the Bank on 3 June 2006.

20. Reserves and retained earnings

	2006 € million	Restated 2005 € million
Revaluation reserve		
At 1 January	2,145	664
Transitional revaluation in prior period of opening balance for fair value of available-for-sale share investments	–	330
At 1 January	2,145	994
Net gains from changes in fair value	601	1,331
Net losses transferred to net profit due to impairment	(6)	(8)
Net gains transferred to net profit on disposal	(698)	(172)
At 31 December	2,042	2,145
Other		
At 1 January	151	139
Internal tax for the year	4	4
Transferred from retained earnings	7	8
At 31 December	162	151
Retained earnings		
At 1 January	1,908	710
Transitional restatement in prior period of opening balance for fair value of financial assets at fair value through profit or loss ¹	–	(85)
Transitional revaluation in prior period of opening balance for fair value of equity derivatives ¹	–	43
Transitional restatement of opening balance for fair value of financial guarantees	–	32
At 1 January as restated	1,908	700
Qualifying fees and commissions	(27)	(14)
Transferred to general reserve	(7)	(8)
Transferred to loan loss reserve	(1)	(292)
Net profit for the year	2,389	1,522
At 31 December	4,262	1,908
Total general reserve	6,466	4,204
Loan loss reserve		
At 1 January	292	–
Transferred from retained earnings	1	292
At 31 December	293	292
Special reserve		
At 1 January	188	174
Qualifying fees and commissions	27	14
At 31 December	215	188
Total reserves and retained earnings	6,974	4,684

¹ These amounts relating to the prior period have been reclassified from the revaluation reserve to retained earnings.

The **general reserve** includes the retention of internal tax paid in accordance with Article 53 of the Agreement Establishing the Bank. This requires that all Directors, Alternate Directors, officers and employees of the Bank be subject to an internal tax imposed by the Bank on salaries and emoluments paid by the Bank and which is retained for its benefit. The balance at the end of the year relating to internal tax is €61 million (2005: €57 million). The general reserve includes the effect of restating the Bank's paid-in capital receivable to a present value basis. Capital receivable and reserves will be accreted back to their future value by 2009 when the final capital instalment is due. The unwinding of the balance sheet reduction will be recognised in the income statement during this period and a transfer from retained earnings to general reserves processed to reflect this.

The **special reserve** is maintained, in accordance with the Agreement, for meeting certain defined losses of the Bank. The special reserve has been established, in accordance with the Bank's financial policies, by setting aside 100 per cent of qualifying fees and commissions received by the Bank associated with loans, guarantees and underwriting the sale of securities, until such time as the Board of Directors decides that the size of the special reserve is adequate. In accordance with the Agreement, €27 million (2005: €14 million) of qualifying fees and commissions recognised in the income statement was appropriated in 2006 from the profit for 2006 and set aside to the special reserve.

In 2005, the Bank created a **loan loss reserve** within members' equity to set aside an amount of retained earnings equal to the difference between the impairment losses expected over the life of the loan portfolio and the amount recognised through the Bank's income statement on an incurred loss basis.

Reserves and retained earnings	2006 € million	Restated 2005 € million
Special reserve	215	188
Loan loss reserve	293	292
Unrealised gains	3,092	2,474
Total restricted reserves	3,600	2,954
Unrestricted general reserves	3,374	1,730
At 31 December	6,974	4,684

The Bank's reserves are used in a number of prudential ratio calculations as well as in determining, in accordance with the Agreement Establishing the Bank, when distributions shall be made to its members. For the purposes of these calculations, the Bank uses unrestricted general reserves to reflect the conservative and prudent financial management practices of the Bank.

Article 36 of the Agreement Establishing the Bank relates to the allocation and distribution of the Bank's net income. It states: "No such allocation, and no distribution, shall be made until the general reserve amounts to at least ten (10) per cent of the authorised capital stock". This threshold is currently €2.0 billion and has been exceeded for the first time during 2006 with unrestricted general reserves of €3.4 billion at 31 December 2006.

21. Operating lease commitments

The Bank leases its headquarters building in London and certain of its Resident Office buildings in countries of operations. These are standard operating leases and include renewal options and periodic escalation clauses. They are mostly non-cancellable in the normal course of business without the Bank incurring substantial penalties. The most significant lease is that for the Bank's headquarters building. Rent payable under the terms of this lease is reviewed every five years and is based on market rates. The last review was concluded in March 2002 and was effective from 25 December 2001.

Minimum future lease payments under long-term non-cancellable operating leases, and payments made under such leases during the year are shown below.

Payable	2006 € million	2005 € million
Not later than one year	30	9
Later than one year and not later than five years	115	113
Later than five years	306	327
At 31 December	451	449
Expenditure	26	25

The Bank has entered into a sub-lease arrangement for a portion of its Moscow Resident Office, which expires in January 2007.

The total minimum future lease payments expected to be received under this sub-lease and income received during the year are shown below:

Receivable	2006 € million	2005 € million
Not later than one year	–	1
At 31 December	–	1
Income	2	3

22. Staff retirement schemes

Defined benefit scheme

A qualified actuary performs a full actuarial valuation of the defined benefit scheme at least every three years using the projected unit method. For IAS 19 purposes this is rolled forward annually to 31 December. The most recent valuation date was 30 June 2005. The present value of the defined benefit obligation and current service cost was calculated using the projected unit credit method.

Amounts recognised in the balance sheet are as follows:

	2006 € million	2005 € million
Fair value of plan assets	153	128
Present value of the defined benefit obligation	(136)	(122)
	17	6
Unrecognised actuarial losses ¹	19	19
Prepayment at 31 December	36	25
Movement in the prepayment (included in "Other assets"):		
At 1 January	25	37
Exchange differences	1	2
Contributions paid	24	13
Total expense as below	(14)	(27)
At 31 December	36	25
The amounts recognised in the income statement are as follows:		
Current service cost	(16)	(14)
Interest cost	(6)	(6)
Prior service cost	–	(14)
Expected return on assets ²	9	8
Amortisation of actuarial loss	(1)	(1)
Total included in staff costs	(14)	(27)

¹ These unrecognised actuarial losses represent the cumulative effect of the historical differences between the actuarial assumptions used in the production of these disclosures and the actual experience of the plan. The primary historical causes of the losses are a lower-than-expected investment return on plan assets, and a decline in the discount rate used to value the plan's liabilities.

² The actual return on assets during the year was €11 million (2005: €22 million).

Principal actuarial assumptions used:

	2006	2005
Discount rate	5.10%	4.75%
Expected return on plan assets	6.75%	6.50%
Future salary increases	4.25%	4.25%
Average remaining working life of employees	15 years	15 years

Actuarial gains and losses in excess of a corridor (10 per cent of the greater of assets or liabilities) are amortised over the remaining working life of employees.

Actual asset allocation	Expected return per annum	2006 € million	Expected return per annum	2005 € million
Equities	8.70%	86	8.10%	78
Index-linked bonds	4.30%	52	4.00%	44
Commodities	4.30%	7	4.00%	6
Derivatives	4.30%	7	4.00%	–
Cash	5.00%	1	4.50%	–
Total	6.75%	153	6.50%	128

Changes in the present value of the defined benefit obligation	2006 € million	2005 € million
Present value of defined benefit obligation at 1 January	122	89
Service cost	16	14
Interest cost	6	6
Prior service cost	–	14
Effect of exchange rate movement	3	3
Actuarial loss arising due to changes in assumptions and experience	3	7
Benefits/disbursements paid	(14)	(11)
Present value of defined benefit obligation at 31 December	136	122

Changes in the fair value of plan assets are as follows:	2006 € million	2005 € million
Opening fair value of plan assets	128	101
Expected return	9	8
Asset gain arising during the year	3	14
Effect of exchange rate movement	3	3
Contributions paid	24	13
Benefits/disbursements paid	(14)	(11)
Total	153	128

History of experience gains and losses	2006 € million	2005 € million	2004 € million	2003 € million	2002 € million
Defined benefit obligation	136	122	90	75	73
Plan assets	153	128	101	84	70
Surplus/(deficit)	17	6	11	9	(3)
Experience gains/(losses) on plan liabilities					
Amount	3	7	3	1	(15)
Percentage of the present value of the plan liabilities	1.4%	6.9%	3.2%	1.0%	(20.1%)
Actual return less expected return on plan assets					
Amount	3	14	4	11	(35)
Percentage of the present value of the plan assets	1.3%	11.0%	3.6%	12.4%	(49.5%)

Defined contribution scheme

The pension charge recognised under the defined contribution scheme was €9 million (2005: €13 million) and is included in “general administrative expenses”.

23. Related parties

The Bank has no related parties other than key management personnel. In sterling terms, salaries and other short-term benefits paid to key management personnel in 2006 amounted to £6 million (2005: £6 million). Key management personnel do not receive post-employment benefits, other long-term benefits, termination benefits or share-based payments.

Key management personnel comprise: the President and Vice Presidents; members of the Bank’s Executive Committee; Business Group Directors; Corporate Directors; the Treasurer; the Director, Risk Management; the Controller; the Director of Human Resources; the Head of Internal Audit; and the Chief Compliance Officer.

The Bank has a number of venture capital associates that it accounts for at fair value through profit or loss. At 31 December 2006, according to unaudited management information or the most recently audited financial statements from the investee companies, these associates had total assets of approximately €29.1 billion (2005: €22.3 billion) and total liabilities of approximately €17.9 billion (2005: €16.5 billion). At 31 December 2006, the associates had revenue of €7.3 billion (2005: €7.9 billion) and made a net profit of approximately €563 million (2005: €505 million).

In addition, the EBRD has provided €48 million (2005: €26 million) of financing to these companies, on which it received €3 million (2005: €1 million) of interest income in the year.

24. Other fund agreements

In addition to the Bank's ordinary operations and the Special Funds programme, the Bank administers numerous bilateral and multilateral grant agreements to provide technical assistance and investment support in the countries of operations. These agreements focus primarily on project preparation, project implementation (including goods and works), advisory services and training. The resources provided by these fund agreements are held separately from the ordinary capital resources of the Bank and are subject to external audit.

At 31 December 2006, the Bank administered 133 technical cooperation fund agreements (2005: 116) amounting to an aggregate of €919 million (2005: €863 million). Of this pledged amount, funds received at 31 December 2006 totalled €854 million. The total uncommitted balance of the funds at 31 December 2006 was €107 million. In addition, the Bank administered 85 project-specific technical cooperation agreements totalling €55 million.

For the specific purpose of co-financing EBRD projects, the Bank also administered 21 investment cooperation fund agreements totalling €132 million, and two EU Pre-accession Preparation Funds totalling €35 million.

Following a proposal by the G-7 countries for a multilateral programme of action to improve safety in nuclear power plants in the countries of operations, the Nuclear Safety Account (NSA) was established by the Bank in March 1993. The NSA funds are in the form of grants and are used for funding immediate safety improvement measures. At 31 December 2006, 16 contributors had made pledges totalling €273 million, using the fixed exchange rates defined in the rules of the NSA.

At their Denver Summit in June 1997, the G-7 countries and the EU endorsed the setting up of the Chernobyl Shelter Fund (CSF). The CSF was established on 7 November 1997, when the rules of the CSF were approved by the Board. It became operational on 8 December 1997, when the required eight contributors had entered into contribution agreements with the Bank. The objective of the CSF is to assist Ukraine in transforming the existing Chernobyl sarcophagus into a safe and environmentally stable system. At 31 December 2006, 24 contributors had made pledges totalling €689 million using the fixed exchange rates defined in the rules of the CSF.

In 1999, in pursuit of their policy to accede to the EU, Lithuania, Bulgaria and the Slovak Republic gave firm commitments to close and decommission their nuclear power plant units with RBMK and VVER 440/230 reactors by certain dates. In response to this, the European Commission announced its intention to support the decommissioning of these reactors with substantial grants over a period of eight to ten years, and invited the Bank to administer three International Decommissioning Support Funds (IDSFs).

On 12 June 2000, the Bank's Board of Directors approved the rules of the Ignalina, Kozloduy and Bohunice IDSFs and the role of the Bank as their administrator. The funds will finance selective projects to help carry out the first phase of decommissioning the designated reactors. They will also finance measures to facilitate the necessary restructuring, upgrading and modernisation of the energy production, transmission and distribution sectors and improvements in energy efficiency, which are a consequence of the closure decisions.

At 31 December 2006, 16 contributors had made pledges to the Ignalina IDSF totalling €512 million; 11 contributors had made pledges to the Kozloduy IDSF totalling €305 million; and nine contributors had made pledges to the Bohunice IDSF totalling €201 million, using the fixed exchange rates defined in the rules of the funds.

In 2001, the Nordic Investment Bank hosted a meeting with participants from Belgium, Finland, Sweden, the European Commission and international financial institutions with activities in the Northern Dimension Area (NDA). At this meeting, participants agreed to establish the Northern Dimension Environmental Partnership (NDEP) to strengthen and coordinate financing of important environmental projects with cross-border effects in the NDA. On 11 December 2001, the Bank's Board of Directors approved the rules of the NDEP Support Fund and the role of the Bank as fund manager. At 31 December 2006, 11 contributors had made pledges totalling €242 million.

Audit fees payable to the Bank's auditors for the 2006 audits of the technical cooperation and nuclear safety funds totalled €320,000 (2005: €313,000). In addition, during 2006 the Bank's auditors, on a global basis, earned €0.2 million (2005: €0.2 million) in respect of due diligence and general business consultancy services funded by the technical cooperation funds. This represents 0.3 per cent of the total spend in 2006 (2005: 0.4 per cent) by the technical cooperation funds on services from consultancy providers in support of the Bank's investments in the countries of operations. These consultancy contracts are awarded in accordance with the Bank's standard procurement rules. Payments to the auditors for consulting and advisory services during the period of audit appointment are recorded on a cash basis and reflect payments to PricewaterhouseCoopers firms.

25. Post-balance sheet events

There have been no material post-balance sheet events that would require disclosure or adjustment to these financial statements. On 6 March 2007, the Board of Directors reviewed the financial statements and authorised them for issue. These financial statements will be submitted for approval to the Annual Meeting of Governors to be held on 21 May 2007.

Summary of Special Funds

Special Funds are established in accordance with Article 18 of the Agreement Establishing the Bank and are administered under the terms of rules and regulations approved by the Bank's Board of Directors. At 31 December 2006, the Bank administered 14 Special Funds: 11 Investment Special Funds and three Technical Cooperation Special Funds. Extracts from the audited financial statements of the Special Funds are summarised in the following tables, together with a summary of contributions pledged by donor country. The Regional Development Initiative Programme Special Fund and the Romania Micro Credit Facility Special Fund were established towards the end of 2006 and hence no financial statements have been prepared for these funds.

Audit fees payable to the Bank's auditors for the 2006 audit of 12 of the Special Funds totalled €78,000 (2005: €74,000).

The objectives of the Special Funds are as follows:

- **Baltic Investment Special Fund and Baltic Technical Assistance Special Fund**
To promote private sector development through support for small and medium-sized enterprises in Estonia, Latvia and Lithuania.
- **Russia Small Business Investment Special Fund and Russia Small Business Technical Cooperation Special Fund**
To assist the development of small businesses in the private sector in the Russian Federation.
- **Financial Intermediary Investment Special Fund**
To support financial intermediaries in the countries of operations of the Bank.
- **Italian Investment Special Fund**
To assist the modernisation, restructuring, expansion and development of small and medium-sized enterprises (SMEs) in certain countries of operations of the Bank.
- **SME Finance Facility Special Fund**
To alleviate the financing problems of SMEs in Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.
- **Balkan Region Special Fund**
To assist the reconstruction of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Former Yugoslav Republic of Macedonia, Montenegro, Romania and Serbia.
- **EBRD Technical Cooperation Special Fund**
To serve as a facility for financing technical cooperation projects in the countries of operations of the Bank.
- **EBRD SME Special Fund**
To assist the development of SMEs in Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, Former Yugoslav Republic of Macedonia, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Montenegro, Romania, Serbia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.
- **Central Asia Risk Sharing Special Fund**
To provide a risk-sharing facility for SME credit lines, micro finance programmes, the Direct Investment Facility and the Trade Facilitation Programme in the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan.
- **Municipal Finance Facility Special Fund**
To alleviate the financing problems of municipalities and their utility companies for small infrastructure investments in Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.
- **Regional Development Initiative Programme Special Fund**
To provide a long-term contribution to sustainable socio-economic development across Azerbaijan and Georgia.
- **Romania Micro Credit Facility Special Fund**
To improve access to finance for micro and small enterprises in Romania.
- **Accounting convention – Investment Special Funds**
The financial statements for the Investment Special Funds have been prepared in accordance with the International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB), and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions. The financial statements have been prepared under the historical cost convention, as modified for the revaluation of available-for-sale financial assets and financial assets held at fair value through profit or loss.
- **Accounting convention – Technical Cooperation Special Funds**
The financial statements for the Technical Cooperation Special Funds have been prepared under the historical cost convention. Contributions and disbursements are accounted for on a cash basis. Interest income and operating expenses are accounted for on an accruals basis.

Investment Special Funds

Extract from the income statement for the year ended
31 December 2006

	Baltic Investment Special Fund € 000	Russia Small Business Investment Special Fund € 000	Financial Intermediary Investment Special Fund € 000	Italian Investment Special Fund € 000
Operating (loss)/profit before provisions	(276)	(2,266)	(341)	489
Release/(charge) for provisions for impairment of loans and guarantees	–	561	(92)	217
(Loss)/profit for the year	(276)	(1,705)	(433)	706

Extract from the balance sheet at
31 December 2006

Loans	–	30,914	8,040	2,105
Provisions for impairment	–	(3,280)	(1,178)	(569)
	–	27,634	6,862	1,536
Share investments at fair value through profit or loss	–	–	–	522
Available-for-sale share investments	5,044	1,158	468	–
	5,044	1,158	468	522
Placements and other assets	4,864	25,857	20,726	22,593
Contributions receivable	–	–	–	–
Total assets	9,908	54,649	28,056	24,651
Other liabilities and provisions for impairment and payments under guarantees	7	4,420	197	2,313
Contributions	7,050	59,351	29,096	21,915
Reserves and retained earnings	2,851	(9,122)	(1,237)	423
Total liabilities and contributors' resources	9,908	54,649	28,056	24,651
Undrawn commitments and guarantees	3,288	68,619	13,980	1,080

Technical Cooperation Special Funds

Extract from the statement of movement in fund balance
and balance sheet for the year ended 31 December 2006

	Baltic Technical Assistance Special Fund € 000
Balance of fund brought forward	1,365
Interest and other income	27
Contributions refunded to donor	(830)
Disbursements	(52)
Other operating expenses	(4)
Balance of fund available	506
Cumulative commitments approved	23,451
Cumulative disbursements	(23,010)
Allocated fund balance	441
Unallocated fund balance	65
Balance of fund available	506

Special Fund contributions pledged by donor

	Baltic Investment Special Fund € 000	Russia Small Business Investment Special Fund € 000	Financial Intermediary Investment Special Fund € 000	Italian Investment Special Fund € 000	SME Finance Facility Special Fund € 000	Balkan Region Special Fund € 000	EBRD SME Special Fund € 000
Austria	–	–	–	–	–	276	–
British Petroleum (BP)	–	–	–	–	–	–	–
Canada	–	2,707	–	–	–	1,472	–
Denmark	1,519	–	–	–	–	750	–
European Community (EC)	–	–	–	–	173,000	–	–
Finland	1,466	–	–	–	–	–	–
France	–	7,686	–	–	–	–	–
Germany	–	9,843	–	–	–	–	–
Iceland	72	–	–	–	–	–	–
Italy	–	8,401	–	21,915	–	–	–
Japan	–	21,162	–	–	–	–	–
Netherlands	–	–	9,500	–	–	–	–
Norway	1,314	–	–	–	–	1,568	–
Romania/EC	–	–	–	–	–	–	–
Sweden	2,679	–	–	–	–	–	–
Switzerland	–	2,360	–	–	–	4,218	–
Taipei China	–	–	23,305	–	–	1,495	–
United Kingdom	–	–	–	–	–	–	–
United States of America	–	7,192	847	–	–	–	37,322
Total at 31 December 2006	7,050	59,351	33,652	21,915	173,000	9,779	37,322

SME Finance Facility Special Fund € 000	Balkan Region Special Fund € 000	EBRD SME Special Fund € 000	Central Asia Risk Sharing Special Fund € 000	Municipal Finance Facility Special Fund € 000	Regional Development Initiative Programme Special Fund € 000	Romania Micro Credit Facility Special Fund € 000	Aggregated Investment Special Funds € 000
(16,954)	(13)	(1,370)	(400)	(227)	3	–	(21,355)
–	–	119	–	–	–	–	805
(16,954)	(13)	(1,251)	(400)	(227)	3	–	(20,550)

–	–	5,740	–	–	–	–	46,799
–	–	(474)	–	–	–	–	(5,501)
–	–	5,266	–	–	–	–	41,298
1,412	–	–	–	–	–	–	1,934
729	–	–	–	–	–	–	7,399
2,141	–	–	–	–	–	–	9,333
22,647	8,603	4,755	9,527	13,909	2,396	–	135,877
60,000	–	1,000	–	19,000	1,595	5,220	86,815
84,788	8,603	11,021	9,527	32,909	3,991	5,220	273,323
4,966	1,399	1,274	68	333	–	–	14,977
173,000	9,779	37,322	9,443	33,000	3,988	5,220	389,164
(93,178)	(2,575)	(27,575)	16	(424)	3	–	(130,818)
84,788	8,603	11,021	9,527	32,909	3,991	5,220	273,323
35,331	5,125	3,229	4,813	7,603	1,519	834	145,421

Russia Small Business Technical Cooperation Special Fund € 000	EBRD Technical Cooperation Special Fund € 000	Aggregated Technical Cooperation Special Funds € 000
7,757	35	9,157
294	1	322
–	–	(830)
(2,029)	(14)	(2,095)
(906)	(1)	(911)
5,116	21	5,643
73,638	1,075	98,164
(69,547)	(1,066)	(93,623)
4,091	9	4,541
1,025	12	1,102
5,116	21	5,643

Central Asia Risk Sharing Special Fund € 000	Municipal Finance Facility Special Fund € 000	Regional Development Initiative Programme Special Fund € 000	Romania Micro Credit Facility Special Fund € 000	Baltic Technical Assistance Special Fund € 000	Russia Small Business Technical Cooperation Special Fund € 000	EBRD Technical Cooperation Special Fund € 000	Aggregated Special Funds € 000
–	–	–	–	–	–	–	276
–	–	3,988	–	–	–	–	3,988
–	–	–	–	–	4,309	–	8,488
–	–	–	–	1,271	–	–	3,540
–	33,000	–	–	–	–	–	206,000
–	–	–	–	1,238	–	–	2,704
–	–	–	–	–	4,980	–	12,666
2,389	–	–	–	–	3,025	–	15,257
–	–	–	–	61	–	–	133
–	–	–	–	–	1,360	–	31,676
–	–	–	–	–	3,295	–	24,457
–	–	–	–	–	–	–	9,500
–	–	–	–	1,101	–	–	3,983
–	–	–	5,220	–	–	–	5,220
–	–	–	–	2,249	–	–	4,928
7,054	–	–	–	–	1,244	–	14,876
–	–	–	–	–	–	–	24,800
–	–	–	–	–	12,824	247	13,071
–	–	–	–	–	29,695	–	75,056
9,443	33,000	3,988	5,220	5,920	60,732	247	460,619

Responsibility for external financial reporting

Management's responsibility

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

The management of the European Bank for Reconstruction and Development ("the Bank") is responsible for the preparation, integrity, and fair presentation of its published financial statements and all other information presented in this Financial Report. The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board and in accordance with the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

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

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

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

The Bank's Board of Directors has appointed an Audit Committee, which assists the Board in its responsibility to ensure the soundness of the Bank's accounting practices and the effective implementation of the internal controls that management has established relating to finance and accounting matters. The Audit Committee consists entirely of members of the Board of Directors. A member of the Audit Committee joins, as an observer, the panel assembled for the selection of the Bank's external auditors. The Audit Committee meets

periodically with management in order to review and monitor the financial, accounting and auditing procedures of the Bank and related financial reports. The external auditors and the internal auditors regularly meet the Audit Committee, with and without other members of management being present, to discuss the adequacy of internal controls over financial reporting and any other matters that they believe should be brought to the attention of the Audit Committee.

The Bank has assessed its internal controls over external financial reporting for 2006. Management's assessment includes the Special Funds and other fund agreements referred to in pages 53–55 of the Financial Report, and the retirement plans. However, the nature of the assessment is restricted to the controls over the reporting and disclosure of these funds, rather than the operational, accounting and administration controls in place for each fund.

The Bank's assessment was based on the criteria for effective internal control over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Based on this assessment, management asserts that, at 31 December 2006, the Bank maintained effective internal controls over its financial reporting as contained in the Financial Report for 2006.

The Bank's external auditors have provided an audit opinion on the fairness of the financial statements presented within the Financial Report. In addition, they have issued an attestation report on management's assessment of the Bank's internal control over financial reporting, as set out on page 57.



Jean Lemierre
President



Manfred Schepers
Vice President, Finance

European Bank for Reconstruction and Development
London

6 March 2007

Responsibility for external financial reporting

Report of the independent auditors

To the Governors of the European Bank for Reconstruction and Development

We have audited management's assessment that the European Bank for Reconstruction and Development ("the Bank") maintained effective internal controls over financial reporting as contained in the Bank's Financial Report for 2006, based on the criteria for effective internal controls over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). Management is responsible for maintaining effective internal controls over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assertion over the effectiveness of the Bank's internal control over financial reporting, based on our review.

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

A bank's internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A bank's internal controls over financial reporting include those policies and procedures that: (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the bank; (ii) provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the bank are being made only in accordance with the authorisation of the bank's management; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the bank's assets that could have a material effect on the financial statements.

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

In our opinion, management's assertion that the Bank maintained effective internal control over financial reporting, as contained in the Bank's Financial Report for 2006, is fairly stated, in all material respects, based on the criteria for effective internal controls over financial reporting described in the "Internal Control – Integrated Framework" issued by the COSO.

We have also audited, in accordance with International Standards on Auditing, the financial statements of the Bank. In our report dated 6 March 2007 we have expressed an unqualified opinion.



PricewaterhouseCoopers LLP
Chartered Accountants
London

6 March 2007

Independent auditors' report

To the Governors of the European Bank for Reconstruction and Development

Report on the financial statements

We have audited the financial statements of the European Bank for Reconstruction and Development ("the Bank") for the year ended 31 December 2006 which comprise the income statement, the balance sheet, the statement of changes in members' equity, the statement of cash flows, the accounting policies, the risk management policies and the notes to the financial statements ("financial statements").

President's responsibility for the financial statements

The President is responsible for the preparation and fair presentation of the financial statements in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board, and in accordance with the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the Bank's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Bank's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion the financial statements present fairly, in all material respects, the financial position of the Bank at 31 December 2006 and its financial performance and cash flows for the year then ended in accordance with the International Financial Reporting Standards issued by the International Accounting Standards Board and the overall principles of the European Community's Council Directive on Annual Accounts and Consolidated Accounts of Banks and Other Financial Institutions.

Other matters

We also report to you if, in our opinion, the financial results section of the Financial Report is not consistent with the financial statements, if the Bank has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We read the other information contained in the Financial Report and consider whether it is consistent with the financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the highlights, financial results, additional reporting and disclosures and Summary of Special Funds. Our responsibilities do not extend to any other information.

This report, including the opinion, has been prepared for, and only for, the Board of Governors as a body in accordance with Article 24 of the Agreement Establishing the Bank dated 29 May 1990, and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come, save where expressly agreed by our prior consent in writing.



PricewaterhouseCoopers LLP

Chartered Accountants and Registered Auditors
London

6 March 2007

Published by the
**European Bank for
Reconstruction and Development**

Edited by the Publishing Unit,
Communications Department.

French, German and Russian language
versions translated by the Translation Unit.

Designed and produced by the Design Unit.

Printed in England by Orchid Print, using
environmental waste and paper recycling
programmes.

Cover printed on Consort Royal and interior
pages on Phoenixmotion Xenon that is acid
free and Totally Chlorine Free (TCF). These
papers are environmentally responsible and
have low emissions during production.



Cover photograph: Yevgeny Kondakov.
Central Kazan, Russia, host city of the
EBRD's 2007 Annual Meeting.

ref: 6907

**European Bank for
Reconstruction and Development**

One Exchange Square
London EC2A 2JN
United Kingdom

Switchboard/central contact

Tel: +44 20 7338 6000
Fax: +44 20 7338 6100
SWIFT: EBRDGB2L

Web site

www.ebrd.com

Requests for publications

Tel: +44 20 7338 7553
Fax: +44 20 7338 6102
Email: pubsdesk@ebrd.com

Project enquiries

Tel: +44 20 7338 7168
Fax: +44 20 7338 7380
Email: projectenquiries@ebrd.com

Information requests

For information requests and general enquiries,
please use the information request form at
www.ebrd.com/inforequest