FINANCIAL REPORT 2011

European Bank
for Reconstruction and Development

The *Financial Report 2011* includes the approved and audited financial statements required to be submitted under Article 27 of the Agreement Establishing the European Bank for Reconstruction and Development and Section 13 of its By-Laws.

The EBRD is changing people's lives and environments from central Europe to central Asia. Working together with the private sector, we invest in projects, engage in policy dialogue and provide technical advice that builds sustainable and open-market economies.
In 2011 the Bank began laying foundations for the expansion of its operations to the southern and eastern Mediterranean (SEMED) region.

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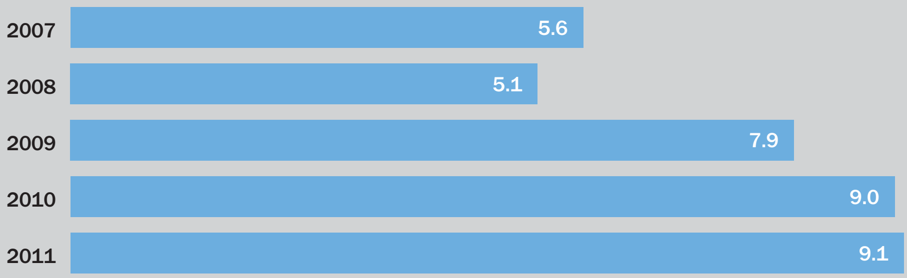
These financial statements have been approved for issue by the Board of Directors on 28 February 2012.

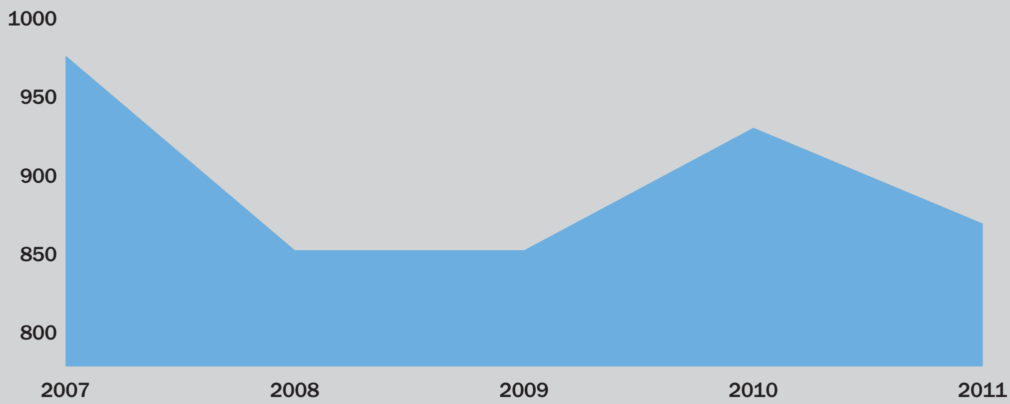
Highlights

EBRD commitments 2007-11*
€ billion



* "Commitments" signifies EBRD financing committed under signed agreements.

Realised profit for the year before impairment 2007-11
€ million



Financial results 2007-11

€ million	2011	2010	2009	2008	2007
Realised profit before impairment[1]	866	927	849	849	973
Net profit/(loss) before transfers of net income	173	1,377	(746)	(602)	1,884
Paid-in capital	6,199	6,197	5,198	5,198	5,198
Reserves and retained earnings	6,974	6,780	6,317	6,552	8,676
Total members' equity	13,173	12,977	11,515	11,750	13,874

Annual investments 2007-11

	2011	2010	2009	2008	2007	Cumulative 1991-2011
Number of projects	380	386	311	302	353	3,374
Annual business volume (€ million)	9,051	9,009	7,861	5,087	5,583	71,147
Non-EBRD finance (€ million)	20,802	13,174	10,353	8,372	8,617	138,605
Total project value[2] (€ million)	29,479	22,039	18,087	12,889	13,809	210,665

[1] Realised profit is before unrealised fair value adjustments to share investments, provisions and other unrealised amounts.
[2] Total project value is the total amount of finance provided to a project, including both EBRD and non-EBRD finance, and is reported in the year in which the project first signs. EBRD financing may be committed over more than one year with "annual business volume" reflecting EBRD finance by year of commitment. The amount of finance to be provided by non-EBRD parties is reported in the year the project first signs.

Financial results

The Bank recorded a net realised profit before Banking loan provisions, unrealised losses on share investments and other unrealised amounts of €866 million (2010: €927 million). Including unrealised amounts, this figure reduced to a net profit of €173 million for 2011 compared with a net profit of €1.4 billion for 2010. The lower profit is a consequence of a fall in the value of the Bank's share investment holdings. This portfolio nevertheless remains €0.3 billion above cost when allowance is made for the valuation of associated derivatives.

The Bank's reserves were €7.0 billion at the end of 2011 (2010: €6.8 billion), reflecting the net profit for the year.

The Bank continues to be rated AAA or equivalent by the major rating agencies. It maintains a strong capital position, high levels of liquidity and enjoys the strong support of its shareholders.

Banking operations

Annual business volume and portfolio

Reported annual business volume[3] amounted to €9.1 billion in 2011, comprising 380 projects and 63 outstanding balances under the 2011 trade facilitation programme (2010: €9.0 billion, 386 projects and 57 trade finance balances). This record level of annual business volume reflects the Bank's continued strong support to the countries of operations that continue to face risks, especially from persistent economic tension in the eurozone.

EBRD financing in 2011 continued to reflect the Bank's strategic priorities. These included a 10 per cent increase to €1.0 billion in funds committed to the EBRD's Early Transition Countries (ETC), with a record 120 transactions signed, and close to €1.0 billion to the Western Balkans. A continued focus on energy efficiency led to an increase of 21 per cent in sustainable energy investments to €2.6 billion, nearly a third of total Bank financing in 2011.

The Bank continued to support all key economic sectors. Projects in the diversified corporate sectors accounted for 30 per cent of 2011 financing, 32 per cent went to the financial sector, with priority given to the SME sector, and the energy and infrastructure sectors accounted for the remaining 38 per cent of 2011 financing.

Net cumulative business volume reached €71.1 billion by the end of 2011 (2010: €62.0 billion). Including co-financing and third-party finance, this amounted to a total project value of €210.7 billion (2010: €178.8 billion). The Bank's portfolio grew from €30.7 billion at the end of 2010 to €34.8 billion at the end of 2011. Reflows were six per cent higher than in 2010, reflecting robust repayment levels from the Bank's loan portfolio which continued to have a low level of non-performing loans – just 2.6 per cent of total loans – down from 2.9 per cent in 2010. The portfolio growth rate was 13 per cent during 2011 compared with 20 per cent in 2010, influenced in part by the strengthening of the US dollar relative to the euro by four per cent.

Gross disbursements reached a record level of €6.7 billion in 2011, an 11 per cent increase on the 2010 level of €6.0 billion. Reported operating assets increased to €24.8 billion at end 2011, up 16 per cent compared with the end 2010 level of €21.3 billion, comprising €18.7 billion of disbursed outstanding loans (2010: €15.8 billion) and €6.1 billion of disbursed outstanding equity investments at historic cost (2010: €5.4 billion).

The Bank's projects attracted significant additional financing in 2011 of €20.8 billion (2010: €13.2 billion). Of this figure the Bank mobilised, through its co-financing activities, a total of €10.2 billion (2010: €5.8 billion), attracting €6.5 billion from the private sector and €3.7 billion from the public sector, with IFIs contributing €2.0 billion of the latter amount (2010: €2.3 billion). A further €10.6 billion was provided to these projects by third-parties. 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.

[3] Commitments made by the Bank in the year, including restructured operations, less cancellations or sales of such commitments within the same time period.

Financial performance

Banking operations recorded a profit of €99 million for 2011 compared with a profit of €1.3 billion in 2010, reflecting the fall in value of the Bank's share investments portfolio. Excluding unrealised fair value movements on the share investments portfolio and provisions charged against the loans portfolio, Banking operations returned a profit of €0.7 billion (2010: €0.7 billion).

The contribution from share investments to the Bank's income statement is expected to continue to show significant variability from year to year, given the volatility of equity markets and the timing of exits. Exits 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.

Treasury operations

Portfolio

The value of assets under Treasury management at 31 December 2011 was €17.6 billion compared with €13.8 billion at the end of 2010. This comprised debt securities of €11.5 billion (2010: €9.6 billion), €5.2 billion of placements with credit institutions (2010: €3.0 billion) and collateralised placements of €0.9 billion (2010: €1.2 billion).

Financial performance

Treasury operations reported an operating profit of €113 million before hedge accounting adjustments compared with €119 million in 2010. The portfolio primarily generates profit through interest income as the majority of assets are accounted for at amortised cost.

Capital

At the 2010 Annual Meeting, the Board of Governors approved an increase to the Bank's authorised capital of €10.0 billion, for which €1.0 billion was capitalised from the Bank's reserves while the other €9.0 billion remains callable. The €9.0 billion of callable capital became effective in April 2011 when subscriptions representing 50 per cent of the number of newly authorised shares was reached. At 31 December 2011 this figure had grown to 85 per cent, resulting in members' equity and callable capital increasing to €35.3 billion from €27.6 billion at the end of 2010.

Paid-in capital totalled €6.2 billion at 31 December 2011 (2010: €6.2 billion), of which €15 million was overdue (2010: €16 million).

Reserves

The Bank's reserves increased from €6.8 billion at the end of 2010 to €7.0 billion at the end of 2011, reflecting the net profit for the year. Unrestricted general reserves increased by €552 million (2010: increased by €1.2 billion), from which €210 million has been set aside for the provision of grants to Chernobyl Projects (€190 million) and for the provision of technical assistance to member countries in the southern and eastern Mediterranean (SEMED) region (€20 million).

Expenses

The Bank continues to focus on budgetary discipline, effective cost controls and a proactive cost-recovery programme. The Bank's general administrative expenses for 2011, including depreciation and amortisation, were €270 million (2010: €250 million). Sterling general administrative expenses for 2011, including depreciation and amortisation, totalled £229 million (2010: £217 million).

Outlook for 2012

The Bank expects its net realised profit to remain relatively stable. However its overall profitability will remain vulnerable to volatility in financial markets, with the fair value of its share investments portfolio and the level of specific debt impairment having particular influence on its profits.

Key financial indicators: 2007-11

Key financial indicators are presented for the Bank over the last five years. These ratios are influenced by the growth in portfolio and annual business volume of the five-year period in line with the Bank's strategy. This business growth utilises the Bank's capital capacity in pursuit of its mandate objectives, while underlying ratios remain at prudent levels broadly consistent with the upper quartile among IFIs in terms of capital strength and cost efficiency.

The Bank's profits and reserves show volatility due to movements in the valuations of share investments. Excluding these movements, the Bank has continued to grow its members' equity in each of the last five years with a 5.1 per cent return on equity on this basis in 2011 (2010: 8.1 per cent). The performance of the Bank's loan assets remains good with a non-performing loan ratio at 31 December 2011 of 2.6 per cent (2010: 2.9 per cent).

Leverage – debt divided by members' equity – has increased to 2.4 times at 31 December 2011 (2010: 1.9 times) reflecting the growth in the Bank's portfolio and the maintenance of a high level of liquidity.

The Bank's capital strength is illustrated by the level of members' equity, which represented 28 per cent of total assets at 31 December 2011 (2010: 33 per cent), including Treasury assets with an average risk rating between AA and AA– with a reduced average maturity. Members' equity represented 54 per cent of Banking assets ('development related exposure') at 31 December 2011 (2010: 61 per cent).

	2011	2010	2009	2008	2007
Financial performance					
1. Return on members' equity – IFRS basis	0%	12%	(2%)	(15%)	14%
2. Return on members' equity – Realised basis	5%	8%	2%	3%	15%
Efficiency					
3. Cost-to-income ratio	25%	24%	25%	17%	22%
Portfolio quality					
4. Non-performing loans ratio	3%	3%	2%	1%	0%
5. Average rating of Treasury liquid assets	2.2	2.4	2.5	2.1	1.9
6. Average maturity of Treasury liquid assets (tenor)	1.3	1.5	1.9	2.1	2.2
Liquidity and leverage					
7. Liquid assets/undisbursed Banking investments plus one-year debt service	88%	82%	74%	96%	103%
8. Debt/members' equity: leverage ratio	241%	192%	172%	157%	127%
Capital strength					
9. Members' equity/total assets	28%	33%	35%	35%	42%
10. Members' equity/Banking assets	54%	61%	64%	77%	88%

Explanatory notes on ratios above:

1. (Total closing members' equity minus total opening members' equity) divided by total opening members' equity. Members' equity adjusted for net income allocations.
2. (Total closing members' equity minus total opening members' equity) divided by total opening members' equity with unrealised Banking fair value adjustments excluded from members' equity and before net income allocations.
3. Total operating expenses divided by total operating income before net movements in equity valuations and Banking and Treasury loan provisions.
4. Total non-performing loans as a percentage of total loan operating assets.
5. Represents the average credit rating weighted by peak counterparty exposure, based on the Bank's internal rating scale as disclosed within the Risk Management: credit risk section of this report.
6. The average tenor of Treasury assets in years is derived as the weighted average time to final maturity, with the exception of asset-backed securities whose final maturity is approximated by the average life of the transaction.
7. Treasury liquid assets divided by total Banking undrawn commitments (undisbursed but committed investments), plus one year's debt service, being debt due for redemption within one year and one year's estimated interest expense.
8. Total borrowings divided by total members' equity.
9. Total members' equity divided by total assets.
10. Total members' equity divided by total Banking assets at fair value.

Additional reporting and disclosures

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 Bank to enable the system of checks and balances on the Bank's activities to function effectively.

The Bank's governing constituent document 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.

Board of Governors

All the powers of the Bank are vested in the Board of Governors, which represents the Bank's 65 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

The Board of Directors comprises 23 Directors and is chaired by the President. Each Director represents one or more shareholders. Subject to the Board of Governors' overall authority, the Board of Directors is responsible for the direction of the Bank'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.

Board Committees

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

The **Audit Committee** assists the Board of Directors in fulfilling its responsibilities in relation to the following:

- the integrity of the Bank's financial statements and its accounting, financial reporting and disclosure policies and practices
- the soundness of the Bank's systems of internal controls that management has established regarding finance and accounting matters and their effective implementation
- the status, the ability to perform duties independently and the performance of the Bank's compliance, internal audit, evaluation and risk management functions
- the independence, qualifications and performance of the Bank's external auditor
- other responsibilities within its remit.

The **Budget and Administrative Affairs Committee** assists the Board of Directors in fulfilling its responsibilities in relation to the following:

- the budgetary, staff and administrative resources of the Bank
- efficiency, cost control and budgetary prudence
- the EBRD Shareholder Special Fund, the use of donor funding and relations with the donor community
- the Bank's Human Resources policies
- specific responsibilities in relation to Governors, the President, Vice Presidents and Directors of the Bank
- policies relating to governance and ethics
- the Bank's administrative arrangements
- other responsibilities within its remit.

The **Financial and Operations Policies Committee** assists the Board of Directors in fulfilling its responsibilities in relation to the following:

- the Bank's financial policies
- the Bank's Treasury operations, Liquidity Policy and Borrowing Programme
- the Bank's operational policies
- the Bank's strategic portfolio management within the framework of the Medium Term Strategy
- transparency and accountability of the Bank's operations within the framework of the Public Information Policy and the Project Complaint Mechanism
- other responsibilities within its remit.

The composition of these committees during 2011 is detailed in the separate Review section of the Annual Report.

The President

The President is elected by the Board of Governors. He is the legal representative and chief of staff of the Bank. Under the direction of the Board of Directors, the President conducts the day-to-day business of the Bank.

The President chairs the Bank's Executive Committee, which also includes the Vice Presidents and other members of the Bank's senior management.

Other Management Committees

Listed below are other management committees that assist the President in the overall management of the Bank.

Management Committees	Chair	Purpose of the Committee	Meeting frequency
Executive Committee	President	The Executive Committee reviews and decides on all aspects of Bank strategy, the budget and day-to-day management falling within the competence of the President and approves submissions to the Board.	Weekly
Operations Committee	First Vice President, Banking	Considers all banking transactions at various stages (concept, structure and final reviews) before submission by the President for consideration by the Board of Directors.	Weekly
Equity Committee	First Vice President, Banking	Maintains oversight over listed and unlisted share investments. Reviews and identifies suitable exit opportunities and makes recommendation on such exits to the Operations Committee.	Quarterly
Procurement Complaints Committee	Deputy General Counsel, Banking and Finance	Considers complaints and disputes arising from tendering and contracts for goods, works and consultant services (including those funded by Cooperation funds or the Bank's budget) subject to the Procurement Policies and Rules or the Corporate Procurement Policy, as the case may be. Reviews procurement and related matters referred to it by the Executive Committee.	As necessary
Technical Cooperation Committee	Vice President, Operational Policies	Decides on all transactional and non-transactional Technical Cooperation proposals except those expressly approved by the Board as being subject to an alternative approval process.	Weekly
Information Technology Governance Committee	Vice President, Risk and Resources	Ensures that the Bank's IT strategy and business plan support the Bank's business strategy. Establishes the framework for measuring business benefits and oversees the realisation of benefits arising from IT projects. Reviews and approves business requests for budget allocation on new projects from the approved IT budget.	At least six times per year
Crisis Management Team	Vice President, Finance and Chief Financial Officer	Prepares coordinated response to all critical internal and external issues arising in connection with events that affect the normal operations of the Bank. Ensures that the crisis management plan and business recovery plan is in place and is tested on a regular basis.	At least three times per year
Strategic Human Resources Committee	President	Approves all senior appointments.	As necessary
Enforcement Committee	Deputy General Counsel, Banking and Finance	Oversees the Bank's policies and procedures for processing allegations of fraud, corruption, collusion or coercion in relation to activities and projects financed from the Bank's ordinary capital resources, Special Funds or cooperation funds administered by the Bank. Decides on whether to take any enforcement action based on a third party finding or in implementation of any agreement for the mutual enforcement of debarment decisions in effect between the Bank and another international organisation.	As necessary

EBRD Codes of Conduct

The Codes of Conduct for Officials of the Board of Directors and for Bank Personnel and Experts, approved in May 2006, articulate the values, duties and obligations, as well as the ethical standards that the Bank expects of its Board officials and staff. A review of these Codes was undertaken in 2011 to evaluate whether, in light of experience, the standards of behaviour required by the Codes were sufficiently clear and robust and in line with the codes of comparator institutions. Revised Codes have been approved by the Board of Directors and, once adopted by the Bank's Board of Governors, these will enter into force in March 2012. Both the current and revised Codes of Conduct prohibit retaliation against whistleblowers.

Compliance

The EBRD 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 can be dismissed by the President only in accordance with guidance given by the Board of Directors in an executive session.

The OCCO's mandate is to promote good governance and ensure that the highest standards of integrity are applied throughout all of the activities of the Bank in accordance with international best practice. The responsibilities of the OCCO include dealing with issues of integrity due diligence, confidentiality, conflicts of interest, accountability, ethics, anti-money-laundering, counter-terrorist financing and the prevention of fraudulent and corrupt practices. The OCCO is responsible for investigating allegations of staff misconduct as well as fraud and corruption in relation to Bank projects and counterparties.

As part of its ongoing efforts to ensure that Bank policies reflect international norms, the Bank, led by the OCCO, introduced new Conduct and Disciplinary Rules and Procedures (CDRPs), effective from March 2011 to replace the Bank's Policy for Reporting and Investigating Suspected Misconduct (PRISM) and its Disciplinary Procedures (DPs), both adopted in 2002. The CDRPs establish a consolidated set of rules and procedures concerning the conduct of staff, the procedures for reporting and investigating suspected misconduct, the process for imposing disciplinary measures and related matters. Among the significant changes introduced by the CDRPs, the rights and duties of both Bank and staff during the investigative and disciplinary processes have been more expressly delineated, including safeguards for the subject of the investigation.

With regard to the processing of fraud and corruption allegations in relation to Bank projects or counterparties, in July 2011 the Bank completed the first proceedings instituted under its Enforcement Policy and Procedures (EPPs), in force since the end of March 2009, resulting in the debarment of two entities. Also in 2011, following the entry into force of the Agreement for the Mutual Enforcement of Debarment Decisions in June 2010, the Bank cross debarred 36 entities and 23 individuals, based on 36 debarment notices received from the World Bank Group and 23 notices received from the Asian Development Bank. The list of all EBRD debarred entities and individuals can be found at www.ebrd.com/pages/about/integrity/list.shtml.

The OCCO also trains and advises, as necessary, Bank staff members who are appointed as directors to the Boards of companies in which the Bank holds an equity interest. Financial and integrity due diligence are integrated into the Bank's normal approval of new business and the monitoring of its existing transactions. The Bank publishes the OCCO's anti-corruption report on its web site.

Moreover, the OCCO has the specific responsibility for administering the Bank's accountability mechanism. This is the Project Complaint Mechanism (PCM), which assesses and reviews complaints about Bank-financed projects and provides, where warranted, a determination as to whether in approving a particular project the Bank acted in compliance with its relevant policies. Within the OCCO, there is a dedicated PCM Officer, appointed by the President, who is responsible for day-to-day implementation of the PCM.

In 2011, the first compliance review was completed in relation to the D1 Motorway Project in the Slovak Republic and the alleged failure of the Bank to properly assess the project's potential impact on protected Natura sites. The compliance review concluded that there was no non-compliance by the Bank. In the course of the year, the PCM received 16 new complaints; ten complaints were manifestly ineligible for consideration under the PCM; three complaints requested problem-solving initiatives by the Bank and five requested compliance reviews. Four of the complaints were on the same project and three of them requested both compliance review and problem-solving initiatives. As a result of the eligibility assessment, a decision was made to recommend one joint problem-solving initiative and one joint compliance review to address issues raised in these four complaints. The joint problem-solving initiative was terminated as a result of the cancellation of the project. The compliance review is still ongoing. The other two complaints submitted in 2011 request Compliance Review and are currently in the process of Eligibility Assessment.

Further information on the registered complaints can be found at www.ebrd.com/pages/project/pcm/register.shtml

Reporting

The EBRD's corporate governance structure is supported by appropriate financial and management reporting. The Bank has a functioning mechanism to be able to certify in the *Financial Report 2011* as to the effectiveness of internal controls over external financial reporting, using the Committee of Sponsoring Organisations of the Treadway Commission internal control framework. This annual certification statement is signed by both the President and the Vice President, Finance and Chief Financial Officer (Vice President Finance) and is subject to a review and an attestation by the Bank's external auditor. In addition, the Bank has a comprehensive system of reporting to its Board of Directors and its committees. This includes reporting to the Audit Committee on the activities of the Evaluation Department and the Internal Audit Department.

Financial risks

Financial risks are discussed in the Risk Management section of this report.

Operational risk

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

- 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
- damage to the Bank's name and reputation, either directly by adverse comments or indirectly
- 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.

The Bank 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 Bank's reputation is of paramount importance and reputational risk has therefore been included in the Bank's definition of operational risk. The Bank will always take all reasonable and practical steps to safeguard its reputation.

Within the Bank, there are policies and procedures in place covering all significant aspects of operational risk. These include first and foremost the Bank'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 Bank'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
- the information security framework
- 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 and Resources Vice Presidency. Risk Management 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. Risk Management drafts proposals that are discussed and reviewed by 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 and Resources (Vice President Risk) and its membership comprises senior managers across the Bank 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 Bank's approach to managing operational risk, and to ensure that it is widely implemented across all areas of the Bank.

The Bank's current operational risk framework includes an agreed definition (see above); the categorisation of different loss type events to capture the Bank's exposure to operational risk; a group of key risk indicators to measure such risks; the identification of specific operational risks through an annual self-assessment exercise; internal loss data collection; and use of external loss data.

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. Departments also report operational risk incident losses or near misses above €5,000. The intention of collecting such data is primarily to improve the control environment by taking into account the cost of control strengthening and perceived potential future losses. The Bank is a member of GOLD, the external loss database where members "pool" operational risk incident information over a monetary threshold. This provides the Bank with access to a depth of information wider than its own experience and supplements its own analysis on reported internal incidents. GOLD is run as an unincorporated not-for-profit consortium of financial services institutions.

For financial risks, please refer to the Risk Management section of the report.

External auditor

The external auditor is appointed by the Board of Directors, on the recommendation of the President, for a four-year term with a maximum of two consecutive terms. PricewaterhouseCoopers LLP completed its second four-year term in 2010. The Bank has appointed Deloitte LLP (UK) as auditor for the period 2011-14.

The external auditor performs an annual audit to enable the firm to express an opinion on whether the financial statements present fairly the financial position and the profit of the Bank in accordance with International Financial Reporting Standards. In addition, the external auditor reviews and offers its 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 its annual audit, the external auditor prepares a management letter for the Board of Governors, setting out its views and management's responses on the effectiveness and efficiency of internal controls and other matters. This letter is reviewed in detail and discussed with the Audit Committee. The Audit Committee reviews the performance and independence of the external auditor annually.

There are key provisions in the Bank's policies regarding the independence of the external auditor. The external auditor is prohibited from providing non-audit related services unless such service is judged to be in the interest of the Bank and unless it is approved by the Audit Committee. However, the external auditor can provide consultancy services paid for by cooperation funds relating to client projects; such incidents are reported periodically to the Audit Committee.

Compensation policy

The Bank 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 enough to attract and retain high calibre employees from a wide range of member countries
- To motivate and encourage superior performance
- To take account of differing levels of responsibility
- To allow the Bank flexibility to respond rapidly to changing conditions
- To support a climate of constant staff development
- To deliver benefits that provide social security in daily life.

To help meet these objectives, the Bank's shareholders have agreed that the Bank should use market comparators to evaluate its staff compensation and that salary and performance-based compensation awards should be driven by performance. Market comparators for the Bank are primarily private sector financial institutions in each of its locations plus other IFIs.

The performance-based compensation awards are structured to recognise individual and team contributions to the Bank's overall performance. These payments represent a limited proportion of the overall total compensation and benefits package provided to staff.

EBRD staff remuneration

All staff on fixed-term or regular contracts receive a salary which is reviewed on 1 April each year. In addition, professional members of staff are eligible to receive a performance-based compensation award depending on the Bank's and the individual staff member's performance.

All fixed-term and regular employees, as well as most of the Board of Directors,[4] the President and Vice Presidents, are covered by medical insurance, participate in the Bank's retirement plans and may be eligible to receive a mortgage subsidy. Professional staff hired from abroad may be eligible for Expatriate/Third Country National status and receive, subject to specific conditions, allowances to assist with relocation, accommodation (to defray the cost of renting or purchasing a home) and the education of their children.

There are two retirement plans in operation. The Money Purchase Plan is a defined contribution scheme to which both the Bank and staff contribute, with Plan members making individual investment decisions. The Final Salary Plan is a defined benefit scheme, to which only the Bank contributes. Both plans provide a lump sum benefit on leaving the Bank or at retirement age, such that retirement plan obligations to staff once they have left the Bank or retired are minimal (being limited to inflation adjustments on undrawn or deferred benefits under each plan). The rules for the retirement plans are approved by the Board of Directors and are monitored by a Retirement Plan Committee, a Retirement Plan Administration Committee and a Retirement Plan Investment Committee.

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

[4] Some Directors and Alternates are paid directly by their constituency and do not participate in the Bank's retirement plans and/or other benefits.

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 Board of Governors. The President can participate in the same benefit schemes as the staff but he is not eligible for performance-based compensation 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 can participate in the same benefit schemes as the staff but are not eligible for performance-based compensation awards.

The gross salary paid in the year from which internal tax is deducted, for each of these positions is as follows:

	2011 £ 000	2011 € 000	2010 £ 000	2010 € 000
President	317	366	313	365
First Vice President, Banking	281	324	279	325
Vice President, Finance and Chief Financial Officer	257	296	255	297
Vice President, Risk and Resources[5]	171	197	255	297
Vice President, Operational Policies[6]	257	296	86	100
Vice President, Environment, Procurement and Administration[7]	n/a	n/a	160	187

The total figures for 2010 include a salary adjustment for the President effective 1 July 2010 and for the Vice Presidents effective 1 April 2010. Salary adjustments for 2011 are not yet approved and therefore not included in the total 2011 figures.

Board of Directors

Directors are elected by the Board of Governors for a term of three years and may be re-elected. 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 schemes as staff but are not eligible for performance-based compensation awards. Some Directors and Alternates are paid directly by the directorship that they represent. In such cases, the funds that would otherwise be used by the Bank to pay such Directors and Alternates are made available to the directorship to offset other eligible costs to the directorship.

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

	2011 £ 000	2011 € 000	2010 £ 000	2010 € 000
Director	135	156	135	157
Alternate Director	112	129	112	131

Senior management

Key management personnel comprises: members of the Bank's Executive Committee; Director of the President's Office; Managing Directors; Corporate Directors; the Treasurer; the Controller; the Director of Human Resources; the Director, Communications; the Head of Internal Audit and the Chief Compliance Officer. This group, excluding the President and Vice Presidents (for whom information is given above), consists of 29 individuals who received gross salaries, from which internal tax is deducted, in the ranges shown in the table below. The average performance-based compensation award for this group was 23 per cent of annual gross salaries in 2011 (2010: 25 per cent).

2011 £ 000	2011 € 000	2010 £ 000	2010 € 000
85 to 203	98 to 234	101 to 191	118 to 223

5 Employed until 31 August 2011.
6 Employed from 1 September 2010.
7 Employed until 31 August 2010.

Income statement

These financial statements have been approved for issue by the Board of Directors on 28 February 2012.

For the year ended 31 December 2011	Note	Year to 31 December 2011 € million	Year to 31 December 2010 € million
Interest and similar income			
From Banking loans		859	645
From fixed-income debt securities and other interest		187	131
Interest expense and similar charges		(263)	(159)
Net interest income	3	783	617
Net fee and commission income	4	20	19
Dividend income		115	66
Net (losses)/gains from share investments at fair value through profit or loss	5	(424)	850
Net gains/(losses) from loans at fair value through profit or loss	6	5	(7)
Net gains from loans at amortised cost		2	–
Net (losses)/gains from Treasury assets held at amortised cost	7	(34)	10
Net gains from dealing activities at fair value through profit or loss	8	57	40
Other losses	9	(35)	(62)
Impairment (provisions)/releases on Banking loan investments	10	(46)	94
General administrative expenses	11	(249)	(228)
Depreciation and amortisation	20,21	(21)	(22)
Net profit for the year from continuing operations		173	1,377
Transfers of net income approved by the Board of Governors		–	(150)
Net profit after transfers of net income approved by the Board of Governors		173	1,227
Attributable to:			
Equity holders		173	1,227

Pages 19 to 76 are an integral part of these financial statements.

Statement of comprehensive income

For the year ended 31 December 2011	Year to 31 December 2011 € million	Year to 31 December 2010 € million
Net profit after transfers of net income approved by the Board of Governors	173	1,227
Other comprehensive income/(expense)		
Share investment designated as fair value through other comprehensive income	2	(1)
Cash flow hedges	15	15
Total comprehensive income	190	1,241
Attributable to:		
Equity holders	190	1,241

Pages 19 to 76 are an integral part of these financial statements.

Balance sheet

At 31 December 2011	Note	€ million	31 December 2011 € million	€ million	31 December 2010 € million
Assets					
Placements with and advances to credit institutions	12	5,172		2,974	
Debt securities	13				
At fair value through profit or loss		411		737	
At amortised cost		11,161		9,065	
Less: Provisions for impairment		(34)		(110)	
		11,538		9,692	
Collateralised placements	14	851		1,179	
			17,561		13,845
Other financial assets	15				
Derivative financial instruments		5,111		4,168	
Other financial assets		517		525	
			5,628		4,693
Loan investments					
Banking portfolio:					
Loans at amortised cost	16	18,088		15,243	
Less: Provisions for impairment	10	(672)		(630)	
Loans at fair value through profit or loss	17	239		221	
			17,655		14,834
Share investments					
Banking portfolio:	18				
At fair value through profit or loss		6,037		5,798	
Treasury portfolio:					
Share investments at fair value through other comprehensive income	19	58		56	
			6,095		5,854
Intangible assets	20		44		47
Property, technology and office equipment	21		38		38
Paid-in capital receivable			15		16
Total assets			47,036		39,327
Liabilities					
Borrowings					
Amounts owed to credit institutions	22	2,610		1,911	
Debts evidenced by certificates	23	29,195		23,036	
			31,805		24,947
Other financial liabilities	24				
Derivative financial instruments		1,643		1,070	
Other financial liabilities		415		333	
			2,058		1,403
Total liabilities			33,863		26,350
Members' equity attributable to equity holders					
Paid-in capital	25		6,199		6,197
Reserves and retained earnings	26		6,974		6,780
Total members' equity			13,173		12,977
Total liabilities and members' equity			47,036		39,327
Memorandum items					
Undrawn commitments	27		10,034		9,394

Pages 19 to 76 are an integral part of these financial statements.

Statement of changes in equity

For the year ended 31 December 2011	Subscribed capital € million	Callable capital € million	Fair value through other comprehensive income reserve € million	Cash flow reserves € million	Retained earnings € million	Total equity € million
At 31 December 2009	19,794	(14,596)	9	(15)	6,539	11,731
Total comprehensive income for the year	–	–	(1)	15	1,227	1,241
Internal tax for the year	–	–	–	–	5	5
Issuance of paid-in shares	999				(999)	–
At 31 December 2010	20,793	(14,596)	8	–	6,772	12,977
Total comprehensive income for the year	–	–	2	15	173	190
Internal tax for the year	–	–	–	–	4	4
Capital subscriptions	7,587	(7,585)	–	–	–	2
At 31 December 2011	28,380	(22,181)	10	15	6,949	13,173

Refer to note 26 "Reserves and retained earnings" for a further explanation of the Bank's reserves.

Pages 19 to 76 are an integral part of these financial statements.

Statement of cash flows

For the year ended 31 December 2011	€ million	Year to 31 December 2011 € million	€ million	Year to 31 December 2010 € million
Cash flows from operating activities				
Net profit for the year	173		1,227	
Adjustments for:				
Unwinding of the discount relating to impaired identified assets	(11)		(7)	
Interest income	(1,035)		(769)	
Interest expenses and similar charges	263		159	
Net deferral of fees and direct costs	101		102	
Realised gains on share investments and equity derivatives	(162)		(338)	
Unrealised losses/(gains) on share investments and equity derivatives at fair value through profit or loss	586		(512)	
Realised gains on Banking loans at amortised cost	(2)		–	
Unrealised losses on dealing securities	–		104	
Fair value movement on hedges	39		62	
Unrealised mark-to-market movement	46		387	
Foreign exchange gains	(4)		–	
Depreciation and amortisation	21		22	
Provisions for impairment of debt securities at amortised cost	27		(10)	
Gross provisions charge/(release) for Banking loan losses	46		(94)	
	88		333	
Interest income received	914		742	
Interest expenses and similar charges paid	(224)		(145)	
(Increase)/decrease in operating assets:				
Prepaid expenses	(93)		(79)	
Proceeds from repayments of Banking loans	4,545		4,176	
Funds advanced for Banking loans	(7,246)		(6,563)	
Proceeds from sale of Banking share investments and equity derivatives	616		759	
Funds advanced for Banking share investments	(1,088)		(928)	
Net placements to credit institutions	(235)		(153)	
Movement in amounts owed to credit institutions	699		(219)	
Increase in operating liabilities:				
Accrued expenses	24		16	
Net cash used in operating activities		(2,000)		(2,061)
Cash flows used in investing activities				
Proceeds from debt securities at amortised cost	11,246		6,069	
Purchases of debt securities at amortised cost	(12,581)		(7,524)	
Proceeds from sale of debt securities held at fair value through profit or loss	1,189		1,177	
Purchases of debt securities held at fair value through profit or loss	(874)		(1,165)	
Purchases of intangible assets, property, technology and office equipment	(19)		(15)	
Net cash used in investing activities		(1,039)		(1,458)
Cash flows from financing activities				
Capital received	4		3	
Issue of debts evidenced by certificates	15,427		15,410	
Redemption of debts evidenced by certificates	(10,756)		(12,312)	
Net cash from financing activities		4,675		3,101
Net increase in cash and cash equivalents		1,636		(418)
Cash and cash equivalents at beginning of the year		2,814		3,232
Cash and cash equivalents at 31 December		4,450		2,814

Cash and cash equivalents[8]	2011 € million	2010 € million
Placements with and advances to credit institutions[9]	4,450	2,814
Cash and cash equivalents at 31 December	4,450	2,814

Pages 19 to 76 are an integral part of these financial statements.

[8] Cash and cash equivalents are amounts with less than three months to maturity from the date of the transactions, which are available for use at short notice and are subject to insignificant risk of change in value. Within the 2011 balance is €20 million restricted for technical assistance to be provided to member countries in the SEMED region.

[9] See note 12 for total amounts in 'placements with and advances to credit institutions'.

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). The financial statements have been prepared under the historical cost convention, as modified by the revaluation of financial assets at fair value through other comprehensive income, 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 which form part of a qualifying hedge relationship have been accounted for in accordance with hedge accounting rules – see “Derivative financial instruments and hedge accounting” within the section for Accounting policies. The financial statements have been prepared on a going concern basis. The going concern assessment is made by the Bank’s Board of Directors at the time of approving the Bank’s annual Liquidity Policy in the fourth quarter of the year and re-confirmed by the President and Vice President Finance on 28 February 2012, the date on which they signed the financial statements.

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 judgements and estimates are significant to the financial statements, are disclosed in “Critical accounting estimates and judgements” within the section for Accounting policies.

Standards, amendments to published standards and interpretations adopted by the Bank
The following standards, amendments to published standards and interpretations relevant to the Bank were adopted in the current year:[10]

IAS 24 (Revised), Related Party Disclosures, is effective for accounting periods beginning on or after 1 January 2011. The revision simplifies the definition of a related party and provides government-related entities partial exemption from the disclosure requirements. The adoption of this revised standard has not had a significant impact on the Bank.

IFRIC 14 (Amendment): Prepayments of a Minimum Funding Requirement, is effective for accounting periods beginning on or after 1 January 2011. The amendment clarifies the treatment of early payment contributions in circumstances where an entity is subject to minimum funding requirements. The amendment permits an entity to treat such early payment as an asset. The adoption of this amendment has not had a significant impact on the Bank.

A number of existing standards were revised by the IASB in May 2010 as part of the IFRS improvements project. The following amendments are relevant to the Bank, but they do not have a significant impact on the Bank’s financial statements:

- IFRS 7, Financial Instruments: Disclosures (effective for accounting periods beginning on or after 1 January 2011)
- IAS 1, Presentation Financial Statements (effective for accounting periods beginning on or after 1 January 2011)
- IAS 27, Consolidated and Separate Financial Statements (effective for accounting periods beginning on or after 1 July 2010)
- IAS 34, Interim Financial Reporting (effective for accounting periods beginning on or after 1 January 2011).

[10] The Bank early adopted the first instalment of IFRS 9: Financial Instruments, concerning the classification and measurement of financial assets, in 2010 – see Annual Report 2010, Financial Report for details.

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

The following standards, amendments to published standards and interpretations are mandatory for the Bank's accounting periods beginning on or after 1 January 2012 or later periods. The Bank has not adopted them early and is currently considering their impact.

Pronouncement	Nature of change	IASB effective date
IFRS 7 (Amendment) Financial Instruments: Disclosures – Transfers of Financial Assets	The standard requires disclosure of information that will assist in understanding the relationship between transferred financial assets that are not derecognised in their entirety and the associated liabilities; as well as information that will assist in the evaluation of the nature of, and risks associated with, the entity's continuing involvement in derecognised financial assets.	Accounting periods beginning on or after 1 July 2011
IFRS 7 (Amendment) Financial Instruments: Disclosures – Offsetting of Financial Assets and Liabilities	The amendment requires disclosure of information that will enable users of an entity's financial statements to evaluate the effect or potential effect of netting arrangements on the entity's financial position.	Accounting periods beginning on or after 1 January 2013
IFRS 9 (Oct 2010): Financial Instruments – Liabilities	The standard maintains the two measurement classifications of amortised cost and fair value through profit or loss for financial liabilities. However, for financial liabilities measured at fair value through profit or loss, changes in fair value due to own credit risk are to be presented in other comprehensive income.	Accounting periods beginning on or after 1 January 2015
IFRS 10: Consolidated Financial Statements	The standard establishes the principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.	Accounting periods beginning on or after 1 January 2013
IFRS 11: Joint Arrangements	The standard establishes the principles for financial reporting by parties to a joint arrangement.	Accounting periods beginning on or after 1 January 2013
IFRS 12: Disclosure of Interests in Other Entities	The standard consolidates the disclosure requirements for interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities.	Accounting periods beginning on or after 1 January 2013
IFRS 13: Fair Value Measurement	The standard defines fair value, establishes a single framework for measuring fair value and requires disclosures about fair value measurements.	Accounting periods beginning on or after 1 January 2013
IAS 1 (Amendment): Presentation of Financial Statements	The amendment requires entities to group items presented in other comprehensive income on the basis of whether they are potentially re-classifiable to profit or loss.	Accounting periods beginning on or after 1 January 2012
IAS 19 (Amendment): Employee Benefits	There are various amendments to the standard including: • elimination of the option to defer the recognition of gains and losses through the use of the corridor method; • streamlining the presentation of changes in assets and liabilities arising from defined benefit plans; • enhancing disclosure requirements for defined benefit plans.	Accounting periods beginning on or after 1 January 2013
IAS 27 (Reissued): Separate Financial Statements	The reissued standard requires an entity preparing separate financial statements to account for investments in subsidiaries, joint ventures and associates at cost or in accordance with IFRS 9: Financial Instruments.	Accounting periods beginning on or after 1 January 2013
IAS 28 (Reissued): Investments in Associates and Joint Ventures	The reissued standard prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.	Accounting periods beginning on or after 1 January 2013
IAS 32 (Amendment) Financial Instruments: Presentation – Offsetting of Financial Assets and Financial Liabilities	The amendment updates the application guidance and basis of conclusions in relation to the offsetting of financial assets and financial liabilities.	Accounting periods beginning on or after 1 January 2014

B. Significant accounting policies

Financial assets – Classification and measurement

The Bank early adopted the first instalment of IFRS 9: Financial Instruments, concerning the classification and measurement of financial assets, with effect from 1 January 2010. Pursuant to that adoption, the Bank classifies its financial assets in the following categories: those measured at amortised cost and those measured at fair value. This classification depends on both the contractual characteristics of the assets and the business model adopted for their management.

Financial assets at amortised cost

An investment is classified as 'amortised cost' only if both of the following criteria are met: the objective of the Bank's business model is to hold the asset to collect the contractual cash flow; and the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding, interest being consideration for the time value of money and the credit risk associated with the principal amount outstanding.

Investments meeting these criteria are measured initially at fair value plus transaction costs that are directly attributable to the acquisition of the financial assets. They are subsequently measured at amortised cost using the effective interest method less any impairment. Except for debt securities held at amortised cost which are recognised on trade date, the Bank's financial assets at amortised cost are recognised at settlement date.

Collateralised placements are measured 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 "total return" swap contract, and represent a form of collateralised lending.

Financial assets at fair value

If either of the two criteria above is not met, the debt instrument is classified as 'fair value through profit or loss'. The presence of an embedded derivative, which could potentially change the cash flows arising on a debt instrument so that they no longer represent solely payments of principal and interest, will require that instrument to be classified at fair value through profit or loss, an example being a convertible loan.

Debt instruments classified at fair value through profit or loss are recognised on a settlement date basis if within the Banking loan portfolio and on a trade date basis if within the Treasury portfolio.

The Bank's share investments – equity investments held within its Banking portfolio – are measured at fair value through profit or loss, including associate investments. The Bank considers the latter to be venture capital investments for which IAS 28: Investments in Associates and Joint Ventures does not require the equity method accounting.

When an instrument which is required to be measured at fair value through profit or loss has characteristics of both a debt and equity instrument, the Bank determines its classification as a debt or an equity instrument on the basis of how the investment was internally appraised and presented at its Operations Committee for approval.

The basis of fair value for listed share investments in an active market is the quoted bid market price on the balance sheet date. The basis of fair value for share investments that are either unlisted or listed in an inactive market is determined using valuation techniques appropriate to the market and industry of each investment. The primary valuation techniques used are net asset value and earnings-based valuations using comparable information and discounted cash flows. Techniques used to support these valuations include industry valuation benchmarks and recent transaction prices.

The Bank's share investments are recognised on a settlement date basis.

At initial recognition, the Bank measures these assets at their fair value. Transaction costs of financial assets carried at fair value through profit or loss are expensed in the income statement. 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 occur.

A strategic equity investment held by Treasury is measured at fair value through other comprehensive income. All fair value gains or losses are recognised in the statement of comprehensive income and not recycled through the income statement.

Derecognition of financial assets

The Bank derecognises a financial asset, or a portion of a financial asset, where the contractual rights to that asset have expired or where the rights to further cash-flows from the asset have been transferred to a third party and, with them, either:

(i) substantially all the risks and rewards of the asset, or

(ii) significant risks and rewards, along with the unconditional ability to sell or pledge the asset.

Where significant risks and rewards have been transferred, but the transferee does not have the unconditional ability to sell or pledge the asset, the Bank continues to account for the asset to the extent of its continuing involvement. Where neither derecognition nor continuing involvement accounting is appropriate, the Bank continues to recognise the asset in its entirety and recognises any consideration received as a financial liability.

Financial liabilities

The Bank has not adopted early that part of IFRS 9 which relates to financial liabilities[11] and therefore still applies IAS 39: Financial Instruments.

With the exception of derivative instruments which must be measured at fair value, the Bank does not designate any financial liabilities at fair value through profit or loss. All are measured at amortised cost, unless they qualify for hedge accounting in which case the amortised cost is adjusted for the fair value attributable to the risks being hedged. Liabilities deriving from issued securities are recognised on a trade date basis with other liabilities on a settlement date basis.

Interest expense is accrued using the effective interest rate method and is recognised within the 'interest expense and similar charges' line of the income statement except for the allocated cost funding Treasury's trading assets which is recognised within 'net gains from dealing activities at fair value through profit or loss'.

Derivative financial instruments and hedge accounting

The Bank primarily makes use of derivatives for three purposes:

(i) the majority of the Bank's issued securities, excluding commercial paper, are individually paired with a swap to convert the issuance proceeds into the currency and interest rate structure sought by the Bank

(ii) to manage the net interest rate risks and foreign exchange risks arising from all of its financial assets and liabilities and

(iii) to provide potential exit strategies for its unlisted equity investments through negotiated put options.

All derivatives are measured at fair value through the income statement unless they form part of a qualifying cash flow hedge, in which case the fair value is taken to reserves and released into the income statement at the same time as the risks on the hedged instrument are recognised therein. 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 hedging instrument) 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 a range of 80 to 125 per cent, with any ineffectiveness within these boundaries recognised within "Fair value movement on non-qualifying and ineffective hedges" in the income statement. The Bank applies hedge accounting treatment to individually identified hedge relationships. Also included within this caption of the income statement are the gains and losses attributable to derivatives that the Bank uses for hedging interest-rate risk on a macro basis, but for which the Bank does not apply hedge accounting.

The Bank documents the relationship between hedging instruments and hedged items upon initial recognition 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 the interest rate risk profile, on both assets and liabilities, into floating rate risk. Such hedges are known as "fair value" hedges. Changes in the fair value of the derivatives that are designated and qualify as fair value hedges, and that prove to be highly effective in relation to hedged risk, are included in the income statement, along with the corresponding change in fair value of the hedged asset or liability that is attributable to that specific hedged risk.

In the case of a fair value hedge of a financial liability, where the hedge ceases to qualify for hedge accounting and the financial liability contains an embedded derivative which is of a different economic character to the host instrument, that embedded derivative is bifurcated and measured at fair value through the income statement. This is not required of hedged financial assets as IFRS 9 does not require bifurcation of embedded derivatives in the case of financial assets.

[11] The IASB's second instalment to IFRS 9, relating to financial liabilities, was issued in October 2010. It is effective for accounting periods beginning on or after 1 January 2015.

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 fluctuates in line with the Bank's view on opportune moments to execute the hedges. 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 time as the relevant expenditure is incurred. At 31 December 2011 the Bank had a number of cash flow hedges in place for future budgeted administrative expenditure to be incurred in sterling.

For further information on risk and related management policies see the Risk Management section of the report.

Financial guarantees

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

Impairment of financial assets

Financial assets at amortised cost

Where there is objective evidence that an identified loan asset is impaired, specific provisions for impairment are recognised in the income statement. Impairment is quantified as the difference between the carrying amount of the asset and the net present value of expected future cash flows discounted at the asset's original effective interest rate where applicable. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. The carrying amount of the asset is reduced directly only upon write-off. 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.

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

- delinquency in contractual payments of principal or interest
- cash flow difficulties experienced by the borrower
- breach of loan covenants or conditions
- initiation of bankruptcy proceedings
- deterioration in the borrower's competitive position
- deterioration in the value of collateral.

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. 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 Bank's methodology calculates impairment on an incurred loss basis. Impairment is deducted from the asset categories on the balance sheet.

The Bank maintains a loan loss reserve to set aside an amount of retained earnings within members' equity 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.

Impairment, less any amounts reversed during the year, is charged to the income statement. When a loan is deemed uncollectible the principal is written off against the related impairment provision. Such loans are written off only after all necessary procedures have been completed and the amount of the loss has been determined. Recoveries are credited to the income statement if previously written off.

Loans and advances are generally renegotiated in response to an adverse change in the circumstances of the borrower. Depending upon the degree to which the original loan is amended, it may continue to be recognised or will be derecognised and replaced with a new loan. To the extent the original loan is retained, it will continue to be shown as overdue if appropriate and individually impaired where the renegotiated payments of interest and principal will not recover the original carrying amount of the asset.

Statement of cash flows

The statement of cash flows is prepared using the indirect method. Cash and cash equivalents comprise balances with less than three months maturity from the date of the transaction, which are available for use at short notice and that are subject to insignificant risk of changes in value.

Foreign currencies

The Bank's reporting currency for the presentation of its financial statements is 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.

Capital subscriptions

The Bank's share capital is denominated in euro.

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 is added to the original cost of the software. Computer software development costs recognised as intangible assets are amortised using the straight-line method over an estimated life of three years.

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

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.

Interest, fees, commissions and dividends
Interest income is recorded on an accruals basis using the effective interest method. Interest is recognised on impaired loans through unwinding the discount used in the present value calculations applied to expected future cash flows.

All interest income is recognised within 'interest and similar income' in the income statement with the exception of interest on trading assets held within Treasury's portfolio which is recognised in 'net gains from dealing activities at fair value through profit or loss'.

Front-end fees and commitment fees are deferred in accordance with IAS 18: Revenue, 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 in accordance with IAS 18 and are presented as 'dividend income' within the Bank's income statement.

Staff retirement plans
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 Bank's contributions to the defined benefit scheme are determined by the Retirement Plan Committee, with advice from the Bank's actuaries, and the contributions are transferred to the scheme's independent custodians.

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. Taxes and duties levied on goods or services are likewise exempted or reimbursable except for those parts of taxes or duties that represent charges for public utility services.

C. Critical accounting estimates and judgements

Preparing financial statements in conformity with IFRS requires the Bank to make estimates and judgements 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. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

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 which are not directly correlated to market risks such as interest rate and foreign exchange risk. The Bank's critical accounting estimates and judgements are as follows:

Fair value of derivative financial instruments

The fair values of the Bank's derivative financial instruments are determined by using discounted cash flow models. These cash flow models are based on underlying market prices for currencies, interest rates and option volatilities. Where market data is not available for all elements of a derivative's valuation, extrapolation and interpolation of existing data has been used. Where unobservable inputs have been used, a sensitivity analysis has been included under "fair value hierarchy" within the Risk Management section of the report.

Fair value of Banking loans at fair value through profit or loss

The fair values of the Bank's loans at fair value through profit or loss are determined by using a combination of discounted cash flow models and options pricing models. These models incorporate market data pertaining to interest rates, borrower's credit spreads, underlying equity prices and dividend cash flows. Where relevant market data is not available extrapolation and interpolation of existing data has been used. Where unobservable inputs have been used, a sensitivity analysis has been included under "fair value hierarchy" within the Risk Management section of the report.

Fair value of share investments

The Bank's method for determining the fair value of share investments is described under "Financial assets" within the Accounting policies section of the report and an analysis of the share investment portfolio is provided in note 18. In relation to the Bank's share investments where the valuations are not based on observable market inputs, additional sensitivity information has been included under "fair value hierarchy" within the Risk Management section of the report.

Provisions for the impairment of loan investments

The Bank's method for determining the level of impairment of loan investments is described within the Accounting policies section of the report and further explained under credit risk within the Risk Management section of the report.

Portfolio provisions for the unidentified impairment of non-sovereign loan investments at 31 December 2011 were €409 million (2010: €378 million). The sensitivity of portfolio provisions to the key variables used in determining the level of impairment is provided below.

Risk ratings

- If all non-sovereign loan investments were upgraded by one category on the Bank's probability of default rating, this would result in a credit to the income statement of €406 million. This credit is due to a reduction of €242 million in portfolio provisions on loan investments, and a reduction of €164 million in specific provisions.
- Conversely, if all non-sovereign loan investments were downgraded by one category on the Bank's probability of default rating this would result in a total charge to the income statement of €1.4 billion. This comprises a charge to the income statement of €67 million in relation to portfolio provisions for non-sovereign loans. On downgrade by one probability of default rating category, 13 per cent of non-sovereign loan investments would become individually impaired. Consequently, specific provisions for identified impairment would have increased by approximately €1.3 billion.

Loss emergence period

- Provisions for unidentified impairment are made to reflect losses arising from events existing but not identified at the balance sheet date and which will emerge within a 12 month period from that date. If the loss emergence period was reduced to three months it is broadly estimated that this would result in a decrease in portfolio provisions charged to the income statement of approximately €300 million. The loan loss reserve would increase by an offsetting amount as the change of the emergence period does not affect the overall estimated loss on the portfolio.

Probability of default rates

- In determining the probabilities of default for each risk rating, the relative weighting applied to external data and the Bank's own experience is reviewed annually. The 2011 general provisioning methodology applies a 50 per cent weighting to the Bank's own experience and a 50 per cent weighting to external data, which is consistent with the methodology approved in the previous year. A decrease in the weighting assigned to the Bank's own experience to 40 per cent (60 per cent external default data) would lead to an increase in portfolio provisions of €47 million, increasing provisions for unidentified impairment of non-sovereign loan investments to €456 million. Similarly, an increase in the weighting assigned to the Bank's own experience to 60 per cent (40 per cent external default data) would lead to a decrease in portfolio provisions of €47 million, decreasing provisions for unidentified impairment of non-sovereign loan investments to €362 million.

Loss given default rates

- A decrease in loss given default rates by 10 percentage points would lead to a decrease in portfolio provisions of €67 million, reducing provisions for unidentified impairment in non-sovereign loans to €342 million.
- An increase in loss given default rates by 10 percentage points would lead to an increase in portfolio provisions for unidentified impairment of non-sovereign loans by €67 million, to a total of €476 million.

Sovereign ratings

- Portfolio provisions for the unidentified impairment of sovereign loan investments at 31 December 2011 amounted to €13 million (2010: €12 million). Due to the Bank's preferred creditor status afforded by its members, a downgrade or upgrade by one risk rating category would not have had a significant impact on the level of sovereign portfolio provisions, and hence the income statement.

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

Risk management

Financial risks

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

In carrying out its mission, the Bank is exposed to financial risks through both its Banking and Treasury activities. The principal financial risks to which the Bank is exposed are credit, market and liquidity risk. The last year saw a significant decline in eastern European equity markets as systemic risks re-emerged as a major concern, leading to a material decline in equity values for the Bank. Debt performance, however, remained relatively strong.

A. 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. 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, and type of instrument or individual transaction.

The Bank is exposed to credit risk in both its Banking and Treasury activities, as borrowers and Treasury counterparties could default on their contractual obligations, or the value of the Bank's investments could become impaired.

Maximum exposure to credit risk before collateral held or other credit enhancements

	2011 € million	2010 € million
Placements with and advances to credit institutions	5,172	2,974
Debt securities at fair value through profit or loss	411	737
Debt securities at amortised cost	11,127	8,955
Collateralised placements	851	1,179
Derivative financial assets	5,111	4,168
Credit default swap exposure[12]	63	113
Other financial assets	517	525
Banking loan investments at amortised cost	17,416	14,613
Banking loan investments at fair value	239	221
Paid-in capital receivable	15	16
Undrawn commitments and guarantees	10,034	9,394
At 31 December	50,956	42,895

The above table represents the worst-case scenario of credit risk exposure to the Bank at 31 December 2011 and 31 December 2010, without taking account of any collateral held or other credit enhancements. Details of collateral and other forms of risk reduction are provided within the respective sections on Banking and Treasury below.

Credit risk in the Banking portfolio: Management

For Banking exposures the Board of Directors approves a credit process document that defines the procedures for the approval, management and review of Banking exposures by the Operations Committee. The Audit Committee reviews the credit process annually and its review is submitted to the Board for approval.

Banking projects are reviewed by the Operations Committee. The Operations Committee is chaired by the First Vice President Banking and its membership comprises senior managers of the Bank. The Operations Committee is responsible for reviewing all Banking operations prior to their submission for Board approval. This includes a number of frameworks for smaller projects which are then each considered by the Small Business Investment Committee. Both committees review projects to ensure they meet the Bank's criteria for sound banking, transition impact and additionality. The Operations Committee operates within the authority delegated by the Board, via the Executive Committee, to approve projects within Board-approved framework operations. The Operations 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 loans.

[12] Credit default swaps are measured at fair value on the balance sheet. This figure represents the additional exposure to the Bank, not already recognised within fair value, should a default event happen requiring the contract to be paid out.

The Bank conducts regular reviews of all exposures within the Banking portfolio, typically on a semi-annual basis. Exposures that are perceived to be more vulnerable to possible default are reviewed more frequently and those that are perceived to be less vulnerable may be reviewed annually. At each review, Risk Management assesses whether there has been any change in the risk profile of the exposure, recommends actions to mitigate risk and reconfirms or adjusts the risk rating. For share investments it also reviews the fair value. At the recommendation of Risk Management, investments considered to be in jeopardy may be transferred from Banking teams to the Corporate Recovery Unit – which reports jointly to Risk Management and Banking – in order to manage the restructuring work-out and recovery process.

The table below shows the Bank's internal probability of default rating scale and how this approximately maps to the external ratings of Standard & Poor's (S&P). References to risk rating through this text relate to probability of default ratings unless otherwise specified.

EBRD internal rating scale	External rating equivalent – S&P	EBRD category
1	AAA	Excellent
2	AA+, AA, AA-	Strong
3	A+, A, A-	Very good
4	BBB+, BBB, BBB-	Good
5	BB+, BB, BB-	Satisfactory
6	B+, B	Acceptable
6W	B-	Watch
7	CCC	Special attention
8	CC	Substandard
9	C	Doubtful
10	D	Expected loss

Disbursements are managed by the Operations Administration Unit (OAU) within the Office of the General Counsel (OGC). The OAU is responsible for checking compliance with the loan agreements and other project agreements and ensuring that correct procedures are followed in line with approved policy. Waivers, consents and amendments of loan covenants and conditionality are prepared by the OAU and are approved by Banking, Risk Management and, where required, by the OGC, the Office of the Chief Economist and the Environment and Sustainability Department.

The portfolio provisioning methodology was revised during the year to increase sector granularity in loss given default methodology. The general portfolio provisions are based on assumed values for the probability of default ratings and the loss given default parameters assigned to each transaction by Risk Management. These assumed values remain more conservative than the Bank's own default and recovery experience. During the year the Bank conducted an external review of its credit rating process and methodology to ensure correct calibration and consistency. As a result of the change in methodology, the impairment charge for portfolio provisions in 2011 was €41 million lower than it would otherwise have been, while the loan loss reserve at December 31 was also €97 million lower as a consequence.

Risk Management reports on the development of the portfolio as a whole on a quarterly basis to the Audit Committee. The report includes a summary of key factors affecting the portfolio and provides analysis and commentary on trends within the portfolio. It also includes commentary on individual exposures in the classified portfolio and measures of exposure against portfolio risk limits, with any breaches of limits reported and explained.

The Bank assigns project, country and overall probability of default ratings to each exposure on an internal scale from 1 (lowest risk) to 10 (highest risk) and loss given default ratings on a scale of 0 per cent to 100 per cent. The project ratings are determined on the basis of the financial strength of the risk counterparty and the risk mitigation built into the project structure, including sponsor support or guarantee. The sovereign rating is assessed internally, taking into consideration the ratings assessed by external rating agencies. For non-sovereign operations, probability of default ratings are normally capped by the local sovereign 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 sovereign rating.

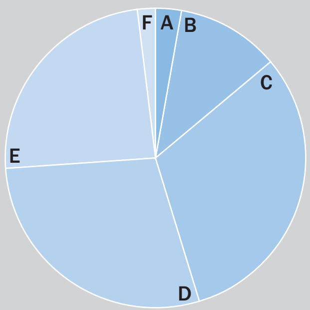
Credit risk in the Banking portfolio: 2011 results

The total Banking exposure (operating assets including fair value adjustments but before provisions) increased during the year from €21.3 billion at 31 December 2010 to €24.4 billion at 31 December 2011. The total signed Banking portfolio (operating assets, excluding fair value adjustments and provisions but including undrawn commitments) increased from €30.6 billion at 31 December 2010 to €34.8 billion at 31 December 2011. The overall probability of default rating of the portfolio improved slightly from 5.79[13] to 5.68.

[13] Computed in line with revised methodology introduced in 2011. Figure quoted in 2010 Financial Report was 5.94.

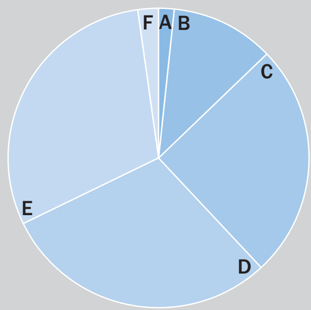
While total non-sovereign operating assets, risk rated 7 to 10, increased in real terms from €3.7 billion[14] to €3.9 billion, as a proportion of the portfolio the figure fell slightly from 18[14] per cent to 16 per cent. Impaired loan assets also increased slightly from €465 million to €484 million.

Credit quality of the loan portfolio
31 December 2011



Risk rating	%
A	3.0
B	10.9
C	31.6
D	28.6
E	24.0
F	1.9

Credit quality of the loan portfolio
31 December 2010



Risk rating	%
A	1.8
B	11.0
C	25.5
D	29.7
E	29.9
F	2.1

The Banking portfolio has exposure to the eurozone[15] both directly and indirectly as a sponsor and a majority owner of Bank projects. Direct exposure occurs in the case of the Bank's three countries of operations located in the eurozone or where loans or investments are to holding companies, typically in France, Netherlands or Cyprus and then on-lent or invested in the Bank's countries of operations.

	Portfolio € million	Operating assets € million	Undrawn € million	% undrawn	% of total eurozone operating assets
Greece	615	608	7	1%	9%
Italy	1,153	1,016	137	12%	15%
Malta	16	–	16	100%	0%
Portugal	149	142	7	5%	2%
Spain	531	433	98	18%	6%
Sub-group 1	2,464	2,199	265	11%	32%
Austria	1,572	1,422	150	10%	21%
Belgium	235	188	47	20%	3%
Estonia	73	64	9	12%	1%
Finland	148	118	30	20%	2%
France	2,054	1,567	487	24%	22%
Germany	990	921	69	7%	14%
Slovak Republic	268	242	26	10%	4%
Slovenia	153	88	65	42%	1%
Sub-group 2	5,493	4,610	883	16%	68%
Total eurozone	7,957	6,809	1,148	14%	100%

14 Figure quoted in 2010 Financial Report was €4.1 billion but as the methodology for determining risk ratings changed in 2011, the prior year's figure has been restated to be on a comparable basis with 2011.
15 Countries are included in sub-group 1 where the sovereign credit default swap is priced in excess of 300 basis points.

Loan investments at amortised cost

Set out below is an analysis of the Banking loan investments and the associated impairment provisions for each of the Bank's internal risk rating categories.

Risk rating	Neither past due nor impaired € million	Past due but not impaired € million	Impaired € million	Total € million	Total %	Portfolio provisions for unidentified impairment € million	Specific provisions for identified impairment € million	Total net of impairment € million	Impairment provisions %
2: Strong	69	–	–	69	0.4	–	–	69	0.0
3: Very good	502	–	–	502	2.8	(1)	–	501	0.2
4: Good	2,285	–	–	2,285	12.6	(6)	–	2,279	0.3
5: Satisfactory	5,739	–	2	5,741	31.6	(24)	(2)	5,715	0.5
6: Acceptable	4,957	–	–	4,957	27.4	(73)	–	4,884	1.5
6W: Watch	2,036	–	–	2,036	11.3	(79)	–	1,957	3.9
7: Special attention	1,999	17	3	2,019	11.2	(239)	(3)	1,777	12.0
8: Substandard	–	–	400	400	2.2	–	(169)	231	42.3
9: Doubtful	–	–	48	48	0.3	–	(45)	3	93.8
10: Expected loss	–	–	31	31	0.2	–	(31)	–	100.0
At 31 December 2011	17,587	17	484	18,088	100.0	(422)	(250)	17,416	–

Risk rating	Neither past due nor impaired € million	Past due but not impaired € million	Impaired € million	Total € million	Total %	Portfolio provisions for unidentified impairment € million	Specific provisions for identified impairment € million	Total net of impairment € million	Impairment provisions %
2: Strong	25	–	–	25	0.2	–	–	25	0.0
3: Very good	133	–	–	133	0.9	(1)	–	132	0.8
4: Good	949	–	–	949	6.2	(11)	–	938	1.2
5: Satisfactory	4,560	–	–	4,560	29.9	(38)	–	4,522	0.8
6: Acceptable	5,249	–	–	5,249	34.4	(86)	–	5,163	1.6
6W: Watch	1,856	–	–	1,856	12.2	(75)	–	1,781	4.0
7: Special attention	1,987	19	–	2,006	13.1	(179)	–	1,827	8.9
8: Substandard	–	–	375	375	2.5	–	(152)	223	40.5
9: Doubtful	–	–	18	18	0.1	–	(16)	2	88.9
10: Expected loss	–	–	72	72	0.5	–	(72)	–	100.0
At 31 December 2010	14,759	19	465	15,243	100.0	(390)	(240)	14,613	–

Of the past due loans, €2 million were outstanding for less than 30 days (2010: nil), €8 million were outstanding for more than 30 days but less than 90 days (2010: €12 million) and €7 million were outstanding for more than 90 days (2010: €7 million).

At 31 December 2011 the estimated value of collateral held over impaired and past due loans was €248 million (2010: €224 million). Most of this collateral is illiquid and therefore difficult to value. As there are normally no recent independent valuations, this value represents the Bank's best estimate. The collateral coverage over the outstanding amount for each impaired loan can vary, as reflected in the specific impairment levels. In general, the Bank requires security for lending to the corporate sector. It also benefits from guarantees and risk-sharing provided by Special Funds (see note 30: Related Parties) which provided credit enhancement of approximately €108 million at the year-end.

Loans at fair value through profit or loss

Set out below is an analysis of the Bank's loans at fair value through profit or loss for each of the Bank's relevant internal risk rating categories.

Risk rating	Fair value 2011 € million	Fair value 2010 € million
5: Satisfactory	17	15
6: Acceptable	36	12
6W: Watch	157	123
7: Special attention	29	71
At 31 December	239	221

Undrawn commitments and guarantees

Set out below is an analysis of the Bank's undrawn commitments and guarantees for each of the Bank's relevant internal risk rating categories.

Risk rating	Undrawn commitments 2011 € million	Guarantees 2011 € million	Undrawn commitments 2010 € million	Guarantees 2010 € million
2: Strong	4	–	4	–
3: Very good	139	2	42	–
4: Good	223	–	378	–
5. Satisfactory	1,973	27	1,335	63
6: Acceptable	4,181	211	4,101	109
6W: Watch	1,862	249	1,674	153
7: Special attention	1,012	64	1,387	140
8: Substandard	86	–	6	–
9: Doubtful	–	–	2	–
10: Expected loss	1	–	–	–
At 31 December	9,481	553	8,929	465

For projects risk rated 8 or worse, it is unlikely that commitments would be drawn down without additional assurances that credit quality would improve. In addition, the Bank would typically have conditions precedent that would need to be satisfied before further disbursements on its debt transactions.

Paid-in capital receivable

Set out below is an analysis of the Bank's paid-in capital receivable at 31 December 2011 and 31 December 2010, none of which was considered impaired.

	2011 € million	2010 € million
Cash and promissory notes due but not yet received	15	16
Paid-in capital receivable at 31 December	15	16

Credit risk in the Banking portfolio: Concentration

The following table breaks down the main Banking credit risk exposures in their carrying amounts by geographic region.

	Loans 2011 € million	Undrawn commitments and guarantees 2011 € million	Total 2011 € million	Loans 2010 € million	Undrawn commitments and guarantees 2010 € million	Total 2010 € million
Albania	277	131	408	211	132	343
Armenia	209	41	250	169	30	199
Azerbaijan	392	236	628	407	107	514
Belarus	60	185	245	83	31	114
Bosnia and Herzegovina	403	467	870	392	485	877
Bulgaria	860	141	1,001	728	398	1,126
Croatia	688	261	949	752	163	915
Czech Republic	34	6	40	43	4	47
Estonia	–	–	–	–	2	2
Former Yugoslav Republic of Macedonia	120	288	408	123	99	222
Georgia	409	165	574	304	306	610
Hungary	480	72	552	495	185	680
Kazakhstan	962	567	1,529	766	751	1,517
Kyrgyz Republic	74	48	122	39	36	75
Latvia	13	85	98	20	97	117
Lithuania	146	–	146	143	16	159
Moldova	154	129	283	135	116	251
Mongolia	175	35	210	162	14	176
Montenegro	93	147	240	60	146	206
Poland	994	478	1,472	832	319	1,151
Romania	1,707	437	2,144	1,510	576	2,086
Russia	4,634	1,681	6,315	4,173	1,461	5,634
Serbia	1,045	896	1,941	791	763	1,554
Slovak Republic	295	38	333	193	120	313
Slovenia	83	61	144	21	2	23
Tajikistan	42	35	77	39	29	68
Turkey	1,211	151	1,362	460	139	599
Turkmenistan	28	3	31	10	3	13
Ukraine	2,154	1,457	3,611	1,937	1,215	3,152
Uzbekistan	69	2	71	86	16	102
Regional	516	1,791	2,307	380	1,633	2,013
At 31 December	18,327	10,034	28,361	15,464	9,394	24,858

The following table breaks down the main Banking credit exposures in their carrying amounts by the industry sector of the counterparty.

	Loans 2011 € million	Undrawn commitments and guarantees 2011 € million	Total 2011 € million	Loans 2010 € million	Undrawn commitments and guarantees 2010 € million	Total 2010 € million
Agribusiness	1,866	482	2,348	1,507	465	1,972
Banking	4,888	895	5,783	4,064	1,206	5,270
Equity funds	–	1,014	1,014	–	828	828
Insurance and financial services	866	168	1,034	522	291	813
Manufacturing and services	1,974	825	2,799	1,867	622	2,489
Municipal and environmental infrastructure	1,259	1,125	2,384	1,063	1,049	2,112
Natural resources	1,299	677	1,976	1,283	374	1,657
Power and energy	2,116	1,660	3,776	1,708	1,350	3,058
Property and tourism	409	459	868	388	494	882
Small business finance	640	159	799	616	63	679
Telecoms, informatics and media	191	81	272	159	65	224
Transport	2,819	2,489	5,308	2,287	2,587	4,874
At 31 December	18,327	10,034	28,361	15,464	9,394	24,858

Credit risk in the Treasury portfolio: Management

For Treasury exposures, the Board of Directors approves a Treasury and Treasury Risk Management Authority (T&TRMA), which defines the risk parameters for funding, cash management, asset and liability management and the investment activities of the Bank. This document is updated annually by the Finance and Risk and Resources Vice Presidencies and approved by the Board. It covers all aspects of Treasury where financial risks arise and also Risk Management's identification, measurement, management and mitigation of the financial risks in Treasury. In addition, Treasury and Treasury Risk Management guidelines have been issued in respect of Treasury risk taking and the related risk management 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 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.

Treasury risks are reviewed by the Treasury Exposure Committee (TEC). The TEC is chaired by the Vice President Finance and its membership comprises senior managers of the Bank. The TEC is responsible for reviewing and monitoring the implementation of the T&TRMA and related guidelines. It assesses Treasury and Risk Management 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. Impairment of Treasury assets is identified by Risk Management, assessed by the TEC and approved by the Vice Presidents of Finance and Risk and Resources.

Maximum credit limits for Treasury counterparties are based on internal credit ratings determined by Risk Management. These ratings are based on internal analysis of approved counterparties' creditworthiness through the synthesis of externally provided credit research and market data, including approved external agency ratings. The internal credit rating scale ranges from 1 (lowest risk) to 10 (highest risk), the same as that used for Banking exposures (a table showing how the Bank's internal rating scale maps to the external ratings of S&P is shown under 'Credit risk' within the Risk Management section of the report). The assigned internal ratings are relative rankings of default risk. When analysing portfolio credit risk within Treasury activities, the Bank maps internal ratings to external rating benchmarks to apply rating transition and default statistics sourced from rating agencies.

Eligible Treasury exposures are normally rated between 1 and 3 (approximately equivalent to S&P AAA to A– ratings), with the exception of counterparties in the countries of operations approved for local currency activities. These transactions support the Bank's initiatives to provide local currency financing to Banking clients and to develop local capital markets. These internal ratings determine the maximum allowable exposures as set out per rating level and counterparty type in the Bank's guidelines for Treasury operations.

The Board-approved T&TRMA states the minimum rating and maximum tenor by type of eligible counterparty. Operational guidelines approved and issued by the Vice President Risk set the maximum exposure size limits per rating class and counterparty type. 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. All individual counterparty lines for banks, corporates and insurance companies are measured, monitored and reviewed by Risk Management annually with a strong surveillance focus, including quarterly reviews on the counterparties with highest risk ratings or with the largest nominal exposures.

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 exposure amounts at future points in time for each counterparty (in practice, 95 per cent eVaR).[16] This includes all transaction types and is measured out to the maturity of the longest dated transaction with that counterparty. Exposures are calculated and controlled against approved limits daily with exceptions escalated to the Managing Director, Risk Management for approval. In 2011, there was a net impairment charge of €27 million against the Treasury credit portfolio (2010: release of €9 million).

Risk mitigation techniques and risk transferring instruments reduce calculated credit exposure measures. For example, Credit Support Annexes for over-the-counter (OTC) derivatives activity reduce potential future exposures in line with collateral posting expectations. Likewise, buying credit protection via a credit default swap usually decreases measured exposure on the reference entity. At 31 December 2011, credit protection of €315 million was held via credit default swaps.

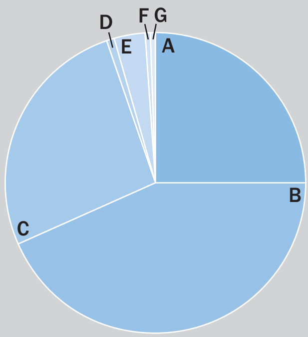
Credit risk in the Treasury portfolio: 2011 results

Treasury peak credit exposure stood at €14.9 billion at 31 December 2011, compared with €11.2 billion at 31 December 2010.

The credit quality of the Treasury portfolio slightly improved during 2011 with the average credit rating weighted by peak counterparty exposure standing at 2.21 at 31 December 2011 (2010: 2.43).[17]

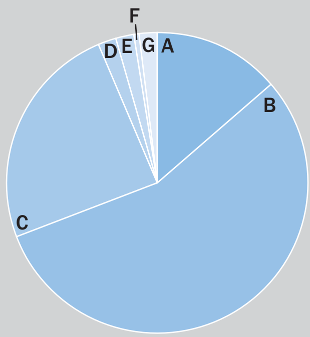
The percentage of Treasury transactions of investment grade quality[18] remained steady at 96 per cent at 31 December 2011 (2010: 95 per cent). Treasury's exposure to below investment grade obligors is limited to counterparties from the countries of operations, a few asset-backed security (ABS) investments originally rated triple-A by leading external rating agencies as well as the impaired financial sector bonds.

Credit quality of the Treasury portfolio
31 December 2011



Risk rating		%
A	1.0	25.0
B	1.7-2.5	43.4
C	2.7-3.3	26.4
D	3.7-4.3	1.0
E	4.7-5.3	3.1
F	5.7-6.3	0.7
G	8.0	0.4

Credit quality of the Treasury portfolio
31 December 2010



Risk rating		%
A	1.0	13.8
B	1.7-2.5	55.6
C	2.7-3.3	24.4
D	3.7-4.3	2.1
E	4.7-5.3	1.7
F	5.7-6.3	0.5
G	8.0	1.9

At 31 December 2011 there were no collateralised placements, Treasury share investments or other financial assets past due or impaired (2010: €nil). All trades within these categories were risk rated 1 (excellent) to 3 (very good) on the Bank's internal risk rating scale for both 2011 and 2010.

[16] VaR is a statistical estimate of the maximum probable loss that can be incurred, due to adverse movements in major risk drivers, over a one-day trading 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.
[17] Refer to the Credit risk section for the Banking portfolio for the internal rating scale.
[18] BBB/Baa3/BBB- level or above.

Placements with and advances to credit institutions

Set out below is an analysis of the Bank's placements with and advances to credit institutions for each of the Bank's relevant internal risk rating categories.

Risk rating	2011 € million	2010 € million
1-3: Excellent to very good	4,894	2,802
4: Good	260	77
5-6: Satisfactory to acceptable	18	95
At 31 December	5,172	2,974

At 31 December 2011 there were no placements with and advances to credit institutions that were past due or impaired (2010: €nil).

Debt securities

Risk Management determines the eligibility of credit exposures based on the internal risk ratings applied and the parameters set out in the T&TRMA and other relevant policies and guidelines. In cases where the creditworthiness of security issuers deteriorates to levels below the standard of eligibility for new exposures, Risk Management and Treasury jointly recommend actions for the approval of the Vice President Risk and the Vice President Finance. Any decision to retain ineligible exposures is reported to the TEC and the Audit Committee.

In cases where the Bank considers the exposure to be permanently reduced in value, impairment for financial assets at amortised cost is recognised in the income statement. Impairment is further discussed under the Accounting policies section of the report.

Debt securities at fair value through profit or loss

Set out below is an analysis of the Bank's debt securities at fair value through profit or loss for each of the Bank's relevant internal risk rating categories. No collateral is held over impaired debt securities.

Risk rating	2011 € million	2010 € million
1-3: Excellent to very good	336	647
4: Good	23	65
5-6: Satisfactory to acceptable	45	7
7-8: Special attention to substandard	7	18
At 31 December	411	737

There were no debt securities at fair value past due in 2011 or 2010.

Debt securities at amortised cost

Set out below is an analysis of the Bank's debt securities at amortised cost for each of the Bank's relevant internal risk rating categories.

Risk rating	Neither past due nor impaired € million	Impaired gross € million	Total € million	Cumulative impairment losses € million	Total net of impairment € million
1-3: Excellent to very good	10,866	–	10,866	–	10,866
4: Good	162	–	162	–	162
5-6: Satisfactory to acceptable	27	–	27	–	27
7-8: Special attention to substandard	–	106	106	(34)	72
At 31 December 2011	11,055	106	11,161	(34)	11,127

Risk rating	Neither past due nor impaired € million	Impaired gross € million	Total € million	Cumulative impairment losses € million	Total net of impairment € million
1-3: Excellent to very good	8,706	–	8,706	–	8,706
4: Good	142	–	142	–	142
5-6: Satisfactory to acceptable	30	–	30	–	30
7-8: Special attention to substandard	–	187	187	(110)	77
At 31 December 2010	**8,878**	**187**	**9,065**	**(110)**	**8,955**

Derivative financial assets

Set out below is an analysis of the Bank's derivatives for each of the Bank's internal rating categories.

Risk rating	2011 € million	2010 € million
1-3: Excellent to very good	4,764	3,628
4: Good	87	52
5-6: Satisfactory to acceptable	182	445
7-8: Special attention to substandard	78	40
9: Doubtful	–	3
At 31 December	5,111	4,168

There were no derivative financial assets past due in 2011 or 2010.

Derivatives

The Bank makes use of derivatives for different purposes within both its Banking portfolio and its Treasury portfolio. Within the Banking portfolio option contracts are privately negotiated with third party sponsors to provide potential exit routes for the Bank on many of its unlisted share investments. These options are never on-sold by the Bank. Within the Treasury portfolio, use of exchange-traded and OTC derivatives is primarily focused on hedging interest rate and foreign exchange risks arising from Bank-wide 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 capital markets are typically swapped into floating-rate debt with derivatives. In addition, Treasury 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 devoted to those risks that are specific to the use of derivatives, through, for example, the monitoring of volatility risk for options, credit spread risk for swaps and basis risk for futures.

The table below shows the fair value of the Bank's derivative financial assets and liabilities at 31 December 2011 and 31 December 2010.

	Assets 2011 € million	Liabilities 2011 € million	Total 2011 € million	Assets 2010 € million	Liabilities 2010 € million	Total 2010 € million
Derivates held for trading						
OTC foreign currency products						
Currency swaps	150	(30)	120	117	(91)	26
Spot and forward currency transactions	195	(76)	119	37	(63)	(26)
	345	(106)	239	154	(154)	–
OTC interest rate products						
Interest rate swaps	96	(151)	(55)	87	(101)	(14)
OTC credit products						
Credit default swaps	14	(7)	7	9	(16)	(7)
Banking derivatives						
Fair value of equity derivatives held in relation to the Banking portfolio	433	(81)	352	573	(30)	543
Total derivatives held for trading and Banking derivatives	888	(345)	543	823	(301)	522
Derivatives held for hedging						
Derivatives designated as fair value hedges						
Interest rate swaps	1,681	(346)	1,335	948	(301)	647
Cross currency interest rate swaps	2,509	(863)	1,646	2,397	(466)	1,931
Embedded derivatives	19	(89)	(70)	–	–	–
	4,209	(1,298)	2,911	3,345	(767)	2,578
Derivatives designated as cash flow hedges						
Forward currency transactions	14	–	14	–	(2)	(2)
Total derivatives held for hedging	4,223	(1,298)	2,925	3,345	(769)	2,576
Total derivatives at 31 December	5,111	(1,643)	3,468	4,168	(1,070)	3,098

In order to manage credit risk in OTC derivative transactions,[19] the Bank'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 limit for the size and tenor of exposure, based on the counterparty's internal credit rating and outlook. Utilisation of limits, whether overall counterparty limits or dedicated foreign exchange and OTC derivatives limits, is calculated using a potential future exposure methodology. This is based on a Monte Carlo simulation-based model and is measured and monitored daily for all counterparties by Risk Management.

OTC derivative transactions are normally carried out only with the most creditworthy counterparties, rated at the internal equivalent of single-A and above. Furthermore, the Bank 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 risk rating.

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 2011, 100 per cent (2010: 93 per cent) of the Bank's gross exposure to derivatives counterparties was against counterparties with whom an MA and CSA had been completed, allowing for receipt of collateral in the form of cash or liquid, triple-A-rated and double A+-rated government securities.

Collateral

The Bank mitigates credit risk by holding collateral against exposures to derivative counterparties.

Counterparty exposure, for the purposes of collateralising credit risk, is only concerned with counterparties with whom the Bank has an overall net positive exposure. At 31 December 2011 this exposure stood at €3.5 billion (2010: €2.8 billion). Against this, the Bank held collateral of €3.3 billion (2010: €2.6 billion), reducing its net credit exposure to €0.2 billion (2010: €0.2 billion).

Where the Bank borrows or purchases securities subject to a commitment to resell them (a reverse repurchase agreement) but does not acquire the risk and rewards of ownership, the transactions are treated as collateralised loans. The securities are not included in the balance sheet and are held as collateral.

The table below illustrates the fair value of collateral held that is permitted to be sold or repledged in the absence of default. Sold or repledged collateral includes collateral on-lent through bond lending activities. In all cases the Bank has an obligation to return equivalent securities.

Collateral held as security	Held collateral 2011 € million	Sold or repledged 2011 € million	Held collateral 2010 € million	Sold or repledged 2010 € million
Derivative financial instruments				
Triple-A-rated government securities	1,808	–	1,900	–
Cash	1,445	1,445	723	723
Reverse sale and repurchase transactions	2,800	–	1,587	–
At 31 December	6,052	1,445	4,210	723

The term "collateralised placements" in the Bank's balance sheet is used to describe the economic substance of the transactions in that category. Such transactions involve the purchase of a financial asset together with entering into a total return swap whereby the risks and rewards of ownership of the asset are transferred back to the entity selling the asset. For accounting purposes, therefore, the economic substance of such transactions is a form of collateralised lending. However as the assets are legally owned by the Bank, they do not represent collateral for the purposes of the above disclosure. At 31 December 2011, the Bank held €0.9 billion (2010: €1.2 billion) of collateralised placements.

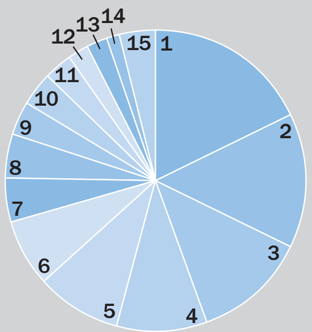
[19] This does not include negotiated options associated with share investments.

Credit risk in the Treasury portfolio: Concentration

Concentration by country and region[20]

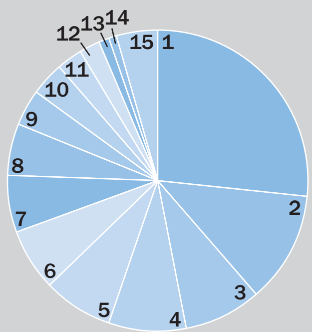
At the end of 2011, Treasury credit risk exposure was allocated across 26 countries. The top five countries (by percentage of the total exposure) were the United States (18 per cent), the Netherlands (14 per cent), France (12 per cent), United Kingdom (10 per cent) and Germany (9 per cent). In 2010 the top five countries (by percentage of the total exposure) were the United States (27 per cent), United Kingdom (12 per cent), France (8 per cent), Spain (8 per cent) and the Netherlands (8 per cent).

Concentration of Treasury peak exposure by country/region
31 December 2011



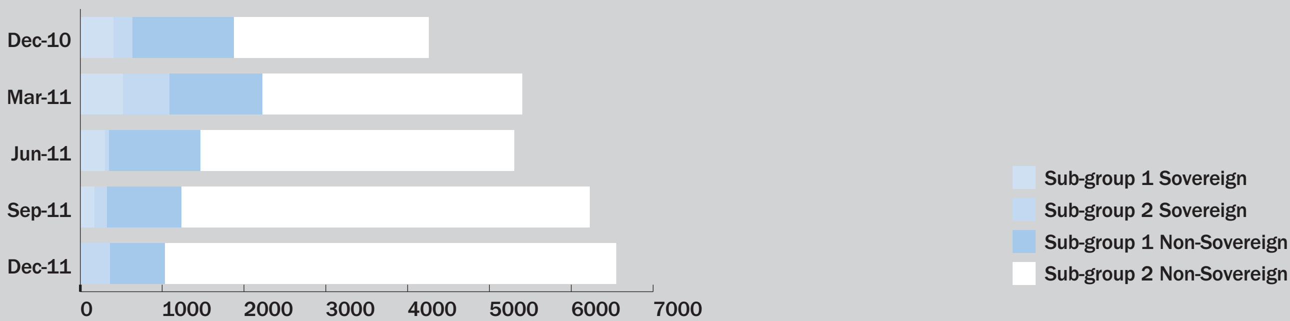
		%
1	USA	18.0
2	Netherlands	14.3
3	France	12.4
4	United Kingdom	9.8
5	Germany	9.0
6	Japan	7.3
7	Sweden	4.8
8	Switzerland	4.5
9	Spain	3.7
10	Canada	3.5
11	Australia	3.0
12	Denmark	2.5
13	Russia	2.1
14	Finland	1.4
15	12 countries with exposure < 1%	3.7

Concentration of Treasury peak exposure by country/region
31 December 2010



		%
1	USA	26.8
2	United Kingdom	11.9
3	France	8.3
4	Spain	8.3
5	Netherlands	7.6
6	Japan	6.5
7	Denmark	6.3
8	Italy	5.4
9	Belgium	4.0
10	Australia	3.6
11	Sweden	2.8
12	Germany	2.2
13	Canada	1.1
14	Russia	1.0
15	14 countries with exposure < 1%	4.2

Month-end peak exposure to eurozone
€ million

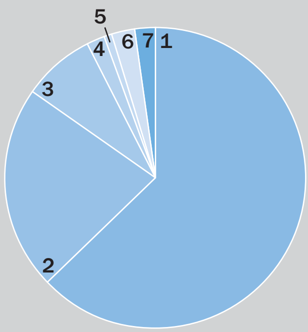


[20] Countries are included in sub-group 1 where the sovereign credit default swap is priced in excess of 300 basis points; this comprises Ireland, Italy and Spain. Sub-group 2 comprises Austria, Belgium, Finland, France, Germany, Luxembourg and the Netherlands.

Concentration by counterparty type

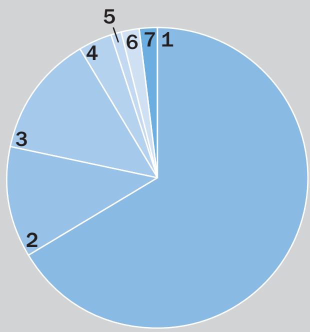
By counterparty type, banks represented the largest portion of the portfolio peak exposure at 63 per cent at 31 December 2011 (2010: 66 per cent). Exposure to counterparties in the countries of operations increased marginally. Direct[21] sovereign exposure increased to 22 per cent (2010: 12 per cent).

Exposure by counterparty type
31 December 2011



	%
1 Banks	62.9
2 Sovereigns	22.0
3 Asset-backed Securities	7.7
4 Insurance Companies	2.0
5 Derivative Product Companies	0.8
6 Corporates	2.4
7 Countries of Operation Counterparties	2.2

Exposure by counterparty type
31 December 2010



	%
1 Banks	66.4
2 Sovereigns	12.0
3 Asset-backed Securities	13.0
4 Insurance Companies	3.7
5 Derivative Product Companies	1.1
6 Corporates	1.9
7 Countries of Operation Counterparties	1.9

B. Market risk

Market risk is the potential loss that could result from adverse market movements. The drivers of market risk are: (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 position and 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 within foreign exchange options. In the market risk area, the year saw markets with increased uncertainty because of the European sovereign debt crisis. This led to a higher volatility in currency movements, an increased currency basis risk and downward pressures on interest rates. Equity markets fell significantly in the third quarter but rallied in the last two months of the year. The most significant market risk is in listed equities (Banking) and its associated foreign exchange risk whereas interest rate risk is kept to a minimum.

Market risk in the Banking portfolio

The Banking loan portfolio is match-funded by Treasury in terms of currency, so for loan facilities extended in currencies other than euro the foreign exchange risk is hedged via the Treasury portfolio. Likewise, interest rate risk to which the Banking loan portfolio would normally be exposed is managed through the Treasury portfolio. As such there is minimal residual foreign exchange or interest rate risk present in the Banking loan portfolio. The main exposure to market risk in the Banking portfolio arises from the exposure of share investments to foreign exchange and equity price risk, neither of which is captured in the VaR figures discussed under "Market risk in the Treasury portfolio". Additional sensitivity information for the Bank's share investments has been included under "fair value hierarchy" later in this section of the report.

[21] Indirect exposure is not included – that is, where the Bank holds government securities as collateral.

Foreign exchange risk

The tables below summarise the potential impact on the Bank's net profit from a strengthening or weakening of foreign exchange rates relative to the euro.

Share investments at fair value through profit or loss

	5 year rolling average movement in exchange rate %	Fair value € million	Impact on net profit € million
Croatian kuna	0.5	556	3
Euro	–	1,804	–
Kazakhstan tenge	3.5	178	6
Polish zloty	3.4	214	7
Romanian leu	5.1	263	13
Russian rouble	4.0	1,336	53
United States dollar	0.1	1,007	1
Other non-euro	2.4	679	16
At 31 December 2011	–	6,037	99

	5 year rolling average movement in exchange rate %	Fair value € million	Impact on net profit € million
Croatian kuna	0.1	450	–
Euro	–	1,486	–
Hungarian forint	2.2	174	4
Kazakhstan tenge	0.5	248	1
Polish zloty	3.7	264	10
Romanian leu	6.4	375	24
Russian rouble	4.0	1,348	54
United States dollar	6.4	693	44
Other non-euro	3.9	760	28
At 31 December 2010	–	5,798	165

Equity price risk

In terms of equity price risk, the Bank expects the effect on net profit will bear a linear relationship to the movement in equity indices. The table below summarises the potential impact on the Bank's net profit from an increase or decrease in relevant benchmark indices.

Share investments at fair value through profit or loss

		5 year rolling average movement in benchmark index %	Fair value € million	Impact on net profit € million
Croatia	CROBEX Index	–	556	–
Hungary	CHTX Index	3.1	121	4
Kazakhstan	KASE Index	2.4	186	4
Poland	WIG Index	0.8	451	3
Romania	BET Index	2.2	263	6
Russia	RTS Index	15.2	2,006	305
Serbia	BELEX15 Index	9.0	142	13
Slovak Republic	SAX Index	11.7	205	24
Ukraine	PFTS Index	35.2	203	71
Regional and other	Weighted average	10.5	1,904	201
At 31 December 2011		–	6,037	631

		5 year rolling average movement in benchmark index %	Fair value € million	Impact on net profit € million
Croatia	CROBEX Index	42.5	450	191
Hungary	CHTX Index	36.0	183	66
Kazakhstan	KASE Index	85.7	252	216
Poland	WIG Index	33.7	308	104
Romania	BET Index	38.4	375	144
Russia	RTS Index	62.7	1,739	1,090
Serbia	BELEX15 Index	63.8	170	108
Slovak Republic	SAX Index	13.4	190	25
Ukraine	PFTS Index	82.3	137	112
Regional and other	Weighted average	54.1	1,994	1,065
At 31 December 2010		–	5,798	3,121

Market risk in the Treasury portfolio

The Bank's market risk exposure arises from the fact that the movement of interest rates and foreign exchange rates may have an impact on positions taken by the Bank.

The Bank monitors its exposure to market risk in its 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 (above a certain threshold) 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. For enhanced comparability across institutions, numbers disclosed in this financial report are also VaR-based and scaled up to a 99 per cent confidence level over a 10-trading-day horizon.

Although eVaR is a more robust measure of market risk than VaR and is used to measure Treasury portfolio risk, it also remains limited by its historical framework insofar as past market events are not necessarily a perfect predictor of future unfolding scenarios. For these reasons a number of other risk measures are employed to complement eVaR and VaR data, with numbers produced using a different set of assumptions and based on a set of risk factor sensitivities. This is also 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 on a daily basis. These primarily encompass:

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

This approach is in line with the needs for complementary risk monitoring as evidenced in the recent market turmoil, and will be further strengthened and refined in light of the lessons learnt from the economic crisis.

The Bank aims to limit and manage market risks 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 Risk Management to ensure compliance with authorised limits. The limits themselves are low compared with the Bank's capital, and in addition to that, actual limit utilisation has been quite low (typically less than 50 per cent). The corresponding profit and loss movements have also been very limited through 2011, illustrating the low risk levels to market risk as specified above.

Interest rate and foreign exchange 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 the extent to which it is exposed to interest rate risk.

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

At 31 December 2011, the aggregate VaR 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 €2.2 million (2010: €1.5 million). Correlation effects in the portfolio reduce the aggregate VaR below the sum of the individual VaR exposures.

The month-end VaR attained its maximum of €3.5 million at the end of November, well within the Board-approved total VaR limit of €27 million for all Treasury funds. The average VaR over the year was €2.1 million (2010: €1.8 million), while the lowest and highest values were €1.3 million and €3.5 million respectively (2010: €1.1 million and €2.7 million).

Market risk exposure incurred by Treasury derives mainly from positions managed internally by Treasury.[22] Within the overall market risk exposure, the VaR of the internally managed portfolios stood at €2.2 million at the end of 2011 (2010: €1.5 million). The range during the year was between €1.1 million and €4.0 million (2010: between €0.7 million and €3.1 million). The size of the internally managed portfolio to which these figures relate was €14.9 billion at 31 December 2011 (2010: €11.2 billion).

The contribution from foreign exchange risk to the overall VaR stood at €0.1 million at year-end (2010: €0.1 million). As in previous years, this contribution was small throughout 2011 and never exceeded €1.6 million (2010: €2.4 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 with option VaR at just €0.03 million at year-end (2010: €0.2 million), having peaked at €1.4 million in August (2010: €1.2 million in April).

In addition to the above, the sterling budget hedges portfolio, tied to the EUR/GBP currency movements, had a stand-alone VaR figure of €18.5 million at year-end. Since the portfolio is not actively managed (nor limit-based), it would be inappropriate to combine the VaR figure with other risk measures for the Treasury portfolio.

Equity price risk

The Bank has direct exposure to equity risk through one Treasury share investment for which the market risk is assessed on a stand-alone basis within a VaR/eVaR framework and added to the overall Treasury risk. Indirect exposure to equity risk occurs in the form of linked structures that are traded on a back-to-back basis and therefore result in no outright exposure.

Commodity price risk

At 31 December 2011 the Treasury portfolio was not exposed to any commodity risk as all such transactions had been performed on a back-to-back basis.

[22] The VaR takes into account Treasury's externally managed portfolio which consists only of cash and short-dated reverse repos, therefore its contribution to the total VaR is minimal. The externally managed portfolio was closed in the third quarter.

C. Liquidity risk

Liquidity risk management process

The Bank's liquidity policy is set out in the Liquidity Policy Review. This document is updated annually and approved by the Board of Directors. The overall liquidity policy within this document sets out the framework that ensures the Bank's ability to meet all its liquidity obligations in the medium term, with further details incorporated within the liquidity management guidelines as part of the Treasury Guidelines. As part of this annual review process, there is an assessment of the Bank's projected liquidity based on projected operational and financial cash flows, together with the proposed Borrowing Programme for the following year. The Bank's liquidity position is also monitored on a monthly basis by the Vice President Risk and the Vice President Finance.

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, and 75 per cent of all committed but undisbursed project financing plus one year's debt service. 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 – above the required minimum level.

For the purposes of the Bank's internal liquidity policies, all assets managed within its Treasury portfolio are considered to represent the Bank's liquidity. On this basis the Bank exceeded the minimum requirement on each of its two key liquidity policies, both at 31 December 2011 and consistently throughout the year. The average weighted maturity of assets managed by Treasury at 31 December 2011 was 1.3 years (2010: 1.5 years).

IFRS 7 Financial Instruments: Disclosures, requires a maturity analysis of the undiscounted cash flows deriving from the Bank's financial liabilities. Cash flows are presented in the earliest maturity band in which they could potentially fall due. For this purpose, the Bank profiles its callable debt in line with options conferring the right to its derivative counterparties to terminate the associated hedging instruments prior to legal maturity. This reflects how the Bank manages its debt in practice despite the fact that the debt is callable at the option of the Bank and therefore there is no legal obligation to redeem the debt before its legal maturity.

Net settling interest rate derivatives typically include interest rate swaps and forward rate agreements. Gross settling interest rate derivatives include cross currency interest rate swaps. While the pay legs of these derivatives must be disclosed, the inflows have also been presented in the accompanying table for information purposes. Foreign exchange derivatives include currency forwards and currency swaps. As exchange-traded interest rate futures and options are cash settled daily, their undiscounted future cash flows at the balance sheet date are negligible.

As the figures represent undiscounted cash flows, they do not agree to the balance sheet.

Financial liabilities at 31 December 2011	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 3 years € million	Over 3 years € million	Total € million
Non-derivative cash flows						
Amounts owed to credit institutions	(2,614)	–	–	–	–	(2,614)
Debts evidenced by certificates	(676)	(2,069)	(5,593)	(8,217)	(17,517)	(34,072)
Other financial liabilities	(2)	(4)	(59)	(81)	–	(146)
At 31 December 2011	(3,292)	(2,073)	(5,652)	(8,298)	(17,517)	(36,832)
Trading derivative cash flows						
Net settling interest rate derivatives	(2)	(5)	(26)	(76)	(55)	(164)
Gross settling interest rate derivatives – outflow	(4)	(123)	(479)	(1,140)	(505)	(2,251)
Gross settling interest rate derivatives – inflow	2	126	483	1,122	480	2,213
Foreign exchange derivatives – outflow	(898)	(1,461)	(348)	–	–	(2,707)
Foreign exchange derivatives – inflow	888	1,418	326	–	–	2,632
Credit derivatives	–	–	–	–	–	–
At 31 December 2011	(14)	(45)	(44)	(94)	(80)	(277)
Hedging derivative cash flows						
Net settling interest rate derivatives	1	(15)	(30)	(121)	(55)	(220)
Gross settling interest rate derivatives – outflow	(97)	(214)	(2,539)	(2,874)	(2,545)	(8,269)
Gross settling interest rate derivatives – inflow	115	162	2,635	2,989	2,273	8,174
At 31 December 2011	19	(67)	66	(6)	(327)	(315)
Total financial liabilities at 31 December 2011	(3,287)	(2,185)	(5,630)	(8,398)	(17,924)	(37,424)
Other financial instruments						
Undrawn commitments						
Financial institutions	(2, 236)	–	–	–	–	(2,236)
Non-financial institutions	(7,798)	–	–	–	–	(7,798)
At 31 December 2011	(10,034)	–	–	–	–	(10,034)

Financial liabilities at 31 December 2010	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 3 years € million	Over 3 years € million	Total € million
Non-derivative cash flows						
Amounts owed to credit institutions	(1,914)	–	–	–	–	(1,914)
Debts evidenced by certificates	(443)	(902)	(4,020)	(7,122)	(14,696)	(27,183)
Other financial liabilities	–	–	(6)	–	(64)	(70)
At 31 December 2010	(2,357)	(902)	(4,026)	(7,122)	(14,760)	(29,167)
Trading derivative cash flows						
Net settling interest rate derivatives	(2)	(8)	(27)	(41)	(40)	(118)
Gross settling interest rate derivatives – outflow	(5)	(31)	(799)	(1,721)	(266)	(2,822)
Gross settling interest rate derivatives – inflow	3	30	763	1,618	288	2,702
Foreign exchange derivatives – outflow	(1,301)	(951)	(974)	–	–	(3,226)
Foreign exchange derivatives – inflow	1,274	920	962	–	–	3,156
Credit derivatives	–	–	(1)	(2)	–	(3)
At 31 December 2010	(31)	(40)	(76)	(146)	(18)	(311)
Hedging derivative cash flows						
Net settling interest rate derivatives	(4)	(6)	4	(49)	(136)	(191)
Gross settling interest rate derivatives – outflow	(16)	(223)	(454)	(794)	(1,465)	(2,952)
Gross settling interest rate derivatives – inflow	23	183	492	904	1,212	2,814
At 31 December 2010	3	(46)	42	61	(389)	(329)
Total financial liabilities at 31 December 2010	(2,385)	(988)	(4,060)	(7,207)	(15,167)	(29,807)
Other financial instruments						
Undrawn commitments						
Financial institutions	(2,796)	–	–	–	–	(2,796)
Non-financial institutions	(6,598)	–	–	–	–	(6,598)
At 31 December 2010	(9,394)	–	–	–	–	(9,394)

In practice, the Bank manages its liquidity risks through a combination of policies which require Treasury to maintain a high proportion of its assets in short-dated tenors together with sufficient liquid assets to meet at least 75 per cent of all obligations falling due within a one-year horizon. In doing so the Bank prudently assumes the earliest possible redemption of liabilities and 100 per cent draw-down of loan commitments.[23] The Bank has a proven record of access to funding in the capital markets via its commercial paper facilities and euro medium-term note programme. The Bank's AAA credit rating was affirmed by the three major rating agencies in 2011, of which two of those opinions were issued in December 2011.

[23] See 'Key financial indicators' on page 7 for a measure of the ratios maintained.

D. Capital management

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.

In accordance with the requirements of Article 5.3 of the Agreement, the Board of Governors reviews the capital stock of the Bank at intervals of not more than five years. At the Annual Meeting in May 2010 the Bank's Board of Governors approved the Fourth Capital Resources Review (CRR4) which established the Bank's strategy for the period 2011 to 2015. 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 medium-term portfolio development strategy and objectives; and a detailed analysis of the Bank's projected future financial performance and capital adequacy. The review underlined that the Bank relies on a strong capital base and stressed the need for prudent financial policies supporting conservative provisioning, strong liquidity and long-term profitability.

As a result of the assessment of capital requirements in CRR4, in May 2010 the Board of Governors approved a two-step increase in the authorised capital stock of the Bank: an immediate €1.0 billion increase in authorised paid-in shares (Resolution No. 126), and a €9.0 billion increase in authorised callable capital shares (Resolution No. 128). This amounts to an aggregate increase in the authorised capital stock of the Bank of €10.0 billion (collectively referred to as the second capital increase). The increase in callable capital became effective on 20 April 2011 when subscriptions were received for at least 50 per cent of the newly authorised callable capital. Subscriptions were originally all to be received on or before 30 April 2011, but the Board of Directors has extended this date to no later than 30 June 2012. The callable shares are subject to redemption in accordance with the terms of Resolution No. 128. At 31 December 2011, €7.6 billion of the callable capital increase had been subscribed.

The Bank does not have any other classes of capital.

The Bank's capital usage is guided by statutory and financial policy parameters. Article 12 of the Agreement establishes a 1:1 gearing ratio which 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. This capital base is defined in the Bank's Reserves, Capital Measurement and Prudential Limits Policy and incorporates unimpaired subscribed capital, the unrestricted general reserves, loan loss reserve, special reserve and adjustments for accumulated specific and general loan impairment provisions and equity losses. This capital base amounted to €35.5 billion at 31 December 2011 (2010: €27.3 billion).

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. The Bank interprets the gearing ratio on a "disbursed" or "operating assets" basis. At 31 December 2011 the Bank's gearing ratio was 70 per cent (2010: 78 per cent). No capital utilisation limits were breached during the year (2010: none). The reduction in the Bank's gearing ratio compared with the end of 2010 reflects the increase to date in subscribed callable capital. As an illustration, if the €9.0 billion increase in callable capital under Resolution 128 had been immediately effective and fully subscribed, the Bank's gearing ratio would have been 67 per cent at 31 December 2011 and 59 per cent at 31 December 2010.

The Bank's statutory measure of capital adequacy under the gearing ratio is supplemented by a risk-based prudential capital adequacy limit under its Economic Capital Policy.

The Bank defines required economic capital as the potential capital losses – both expected and unexpected – it may incur based on probabilities consistent with the Bank's 'triple-A' credit rating. The main risk categories assessed under the economic capital framework are credit risk, market risk and operational risk, and the total risk is managed within an available economic capital base that excludes callable capital, while maintaining a prudent capital buffer.

One of the main objectives of the Economic Capital Policy is to manage the Bank's capital within a medium-term planning framework, providing a consistent measurement of capital headroom over time. The Bank's objective is to prevent the need to call on subscribed callable capital and to use only available risk capital including paid-in capital, reserves and provisions. The available economic capital managed by the Bank consists of paid-in capital, the unrestricted general reserves, loan loss reserve, special reserve and adjustments for accumulated general loan impairment provisions and equity losses, assessed at the period end. This capital base amounted to €13.1 billion at 31 December 2011 (2010: €12.5 billion).

At 31 December 2011 the ratio of required economic capital to available economic capital was 75 per cent, compared with a policy threshold for this ratio of 90 per cent (2010: 69 per cent). The Bank's risk-based capital under this policy is managed alongside the Bank's statutory capital constraint.

The Bank's prudent approach to capital management is reflected in the key financial ratios presented on page 7. At 31 December 2011, the ratio of members' equity to total assets was 28 per cent (2010: 33 per cent) and the ratio of members' equity to banking assets was 54 per cent (2010: 61 per cent).

E. Fair value of financial assets and liabilities

Classification and fair value of financial assets and liabilities

Financial assets at 31 December 2011	Carrying amount € million	Fair value € million
Financial assets measured at fair value through profit or loss or fair value through other comprehensive income:		
– Debt securities	411	411
– Derivative financial instruments	5,111	5,111
– Banking loans at fair value through profit or loss	239	239
– Banking portfolio: Share investments at fair value through profit or loss	6,037	6,037
– Treasury portfolio: Share investments at fair value through other comprehensive income	58	58
	11,856	11,856
Financial assets measured at amortised cost:		
– Placements with and advances to credit institutions	5,172	5,172
– Debt securities	11,127	10,569
– Collateralised placements	851	891
– Other financial assets	517	517
– Banking loan investments at amortised cost	17,416	17,621
– Paid in capital receivable	15	15
	35,098	34,766
Total	46,954	46,622

Financial assets at 31 December 2010	Carrying amount € million	Fair value € million
Financial assets measured at fair value through profit or loss or fair value through other comprehensive income:		
– Debt securities	737	737
– Derivative financial instruments	4,168	4,168
– Banking loans at fair value through profit or loss	221	221
– Banking portfolio: Share investments at fair value through profit or loss	5,798	5,798
– Treasury portfolio: Share investments at fair value through other comprehensive income	56	56
	10,980	10,980
Financial assets measured at amortised cost:		
– Placements with and advances to credit institutions	2,974	2,974
– Debt securities	8,955	8,647
– Collateralised placements	1,179	1,118
– Other financial assets	525	525
– Banking loan investments at amortised cost	14,613	14,306
– Paid in capital receivable	16	16
	28,262	27,586
Total	39,242	38,566

Financial liabilities at 31 December 2011	Held for trading € million	At fair value through profit or loss € million	Derivatives held for hedging purposes € million	Financial liabilities at amortised cost € million	Carrying amount € million	Fair value € million
Amounts owed to credit institutions	–	–	–	(2,610)	(2,610)	(2,610)
Debts evidenced by certificates	–	–	–	(29,195)	(29,195)	(29,056)
Derivative financial instruments	(264)	(81)	(1,298)	–	(1,643)	(1,643)
Other financial liabilities	–	–	–	(415)	(415)	(415)
Total financial liabilities	(264)	(81)	(1,298)	(32,220)	(33,863)	(33,724)

Financial liabilities at 31 December 2010	Held for trading € million	At fair value through profit or loss € million	Derivatives held for hedging purposes € million	Financial liabilities at amortised cost € million	Carrying amount € million	Fair value € million
Amounts owed to credit institutions	–	–	–	(1,911)	(1,911)	(1,911)
Debts evidenced by certificates	–	–	–	(23,036)	(23,036)	(22,748)
Derivative financial instruments	(271)	(30)	(769)	–	(1,070)	(1,070)
Other financial liabilities	–	–	–	(333)	(333)	(333)
Total financial liabilities	(271)	(30)	(769)	(25,280)	(26,350)	(26,062)

At 31 December 2011, the Bank's balance sheet approximates to fair value in all financial asset and liability categories, with the exception of debt securities at amortised cost, loan investments at amortised cost and debts evidenced by certificates.

The basis of fair value for debt securities listed in an active market is the quoted bid market price on the balance sheet date.

The basis of fair value for debt securities that are unlisted or listed in an inactive market is determined using valuation techniques appropriate to the market and industry of each investment. The primary valuation techniques used are quotes from brokerage services and discounted cash flows. Techniques used to support these valuations include industry valuation benchmarks and recent transaction prices.

Banking loan investments whereby the objective of the Bank's business model is to hold these investments to collect the contractual cash flow, and the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest, are recognised at amortised cost. The fair value of these loans was calculated by discounting the cash flows at a year end interest rate applicable to each loan and further discounting the value by an internal measure of credit risk.

"Debts evidenced by certificates" represents the Bank's borrowing activities executed through the issuance of commercial paper and bonds. Due to the short-tenor nature of commercial paper, amortised cost approximates fair value.

Fair value hierarchy

IFRS 7 specifies classification of fair values on the basis of a three-level hierarchy of valuation methodologies. The classifications are determined based on whether the inputs used in the measurement of fair values are observable or unobservable. These inputs have created the following fair value hierarchy:

- Level 1 – Quoted prices in active markets for identical assets or liabilities. This level includes listed share investments on stock exchanges.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices). This level includes debt securities and most derivative products. The sources of inputs include prices available from screen-based services such as Reuters and Bloomberg, broker quotes and observable market data such as interest rates and foreign exchange rates which are used in deriving the valuations of derivative products.
- Level 3 – Inputs for the asset or liability that are not based on observable market data (unobservable inputs). This level includes share investments and debt securities or derivative products for which not all market data is observable.

The table below provides information at 31 December 2011 about the Bank's financial assets and financial liabilities measured at fair value. Financial assets and financial liabilities are classified in their entirety based on the lowest level input that is significant to the fair value measurement.

	At 31 December 2011			
	Level 1 € million	Level 2 € million	Level 3 € million	Total € million
Debt securities	–	209	202	411
Derivative financial instruments	–	4,678	433	5,111
Banking loans	–	–	239	239
Share investments (Banking portfolio)	952	–	5,085	6,037
Share investments (Treasury portfolio)		58	–	58
Total financial assets at fair value	952	4,945	5,959	11,856
Derivative financial instruments	–	(1,560)	(83)	(1,643)
Total financial liabilities at fair value	–	(1,560)	(83)	(1,643)

	At 31 December 2010			
	Level 1 € million	Level 2 € million	Level 3 € million	Total € million
Debt securities	–	540	197	737
Derivative financial instruments	–	3,578	590	4,168
Banking loans	–	–	221	221
Share investments (Banking portfolio)	1,792	–	4,006	5,798
Share investments (Treasury portfolio)	–	56	–	56
Total financial assets at fair value	1,792	4,174	5,014	10,980
Derivative financial instruments	–	(1,029)	(41)	(1,070)
Total financial liabilities at fair value	–	(1,029)	(41)	(1,070)

There have been no transfers between Level 1 and Level 2 during the year.

The table below provides a reconciliation of the fair values of the Bank's Level 3 financial assets and financial liabilities for the year ended 31 December 2011.

	Level 3 financial assets and financial liabilities Year ended 31 December 2011						
	Debt securities € million	Derivative financial instruments € million	Banking loans € million	Banking share investments € million	Total assets € million	Derivative financial instruments € million	Total liabilities € million
Balance at 31 December 2010	197	590	221	4,006	5,014	(41)	(41)
Total gains/(losses) for the year ended 31 December 2011 in:							
Net (loss)/profit	6	(142)	21	232	117	(42)	(42)
Purchases/issues	–	–	38	968	1,006		
Sales/settlements	(14)	(15)	(41)	(422)	(492)		
Transfers in/(out) of Level 3	13	–	–	301	314		
Balance at 31 December 2011	202	433	239	5,085	5,959	(83)	(83)
Total gains/(losses) for the period included in net profit for assets and liabilities held at 31 December 2011	(2)	102	21	242	363	75	75

	Level 3 financial assets and financial liabilities Year ended 31 December 2010						
	Debt securities € million	Derivative financial instruments € million	Banking loans € million	Banking share investments € million	Total assets € million	Derivative financial instruments € million	Total liabilities € million
Balance at 31 December 2009	155	234	–	3,293	3,682	(96)	(96)
IFRS 9 reclassification	–	150	113	302	565	–	–
Balance at 1 January 2010	155	384	113	3,595	4,247	(96)	(96)
Total gains/(losses) for the year ended 31 December 2010 in:							
Net (loss)/profit	(5)	221	(4)	108	320	57	57
Purchases/issues	–	–	138	801	939	(2)	(2)
Sales/settlements	(37)	(15)	(26)	(408)	(486)	–	–
Transfers in/(out) of Level 3	84	–	–	(90)	(6)	–	–
Balance at 31 December 2010	197	590	221	4,006	5,014	(41)	(41)
Total gains/(losses) for the period included in net profit for assets and liabilities held at 31 December 2010	10	216	(4)	367	589	57	57

Level 3 – sensitivity analysis

The table below presents the Level 3 financial instruments carried at fair value at 31 December 2011, main valuation models/techniques[24] used in the valuation of these financial instruments and reasonably possible increases or decreases in fair value based on reasonably possible alternative assumptions:

Assets	Main valuation models/techniques	Impact on net profit in 2011 Carrying amount € million	Favourable change € million	Unfavourable change € million
Debt securities	Discounted cash flow models, broker quotes and observable market data	202	34	(1)
Derivative financial instruments	Discounted cash flow models	–	–	–
Banking derivatives	NAV and EBITDA multiples, discount cash flow models, compounded interest and option pricing models	433	88	(46)
Banking loans	Discount cash flow and option pricing models	239	6	(21)
Banking share investments	NAV and EBITDA multiples, discount cash flow models	5,085	496	(863)
At 31 December		5,959	624	(931)

Liabilities	Main valuation models/techniques	Impact on net profit in 2011 Carrying amount € million	Favourable change € million	Unfavourable change € million
Derivative financial instruments	Discounted cash flow models	(2)	–	(1)
Banking derivatives	NAV multiples, EBITDA multiples, discount cash flow models, compounded interest	(81)	16	(8)
At 31 December		(83)	16	(9)

Assets	Main valuation models/techniques	Impact on net profit in 2010 Carrying amount € million	Favourable change € million	Unfavourable change € million
Debt securities	Broker quotes and observable market data	197	10	(2)
Derivative financial instruments	Discounted cash flow models	17	–	(3)
Banking derivatives	NAV multiples, EBITDA multiples, discount cash flow models, compounded interest	573	37	(98)
Banking loans	Discount cash flow and option pricing models	221	14	(49)
Banking share investments	NAV multiples, EBITDA multiples, discount cash flow models	4,006	256	(688)
At 31 December		5,014	317	(840)

Liabilities	Main valuation models/techniques	Impact on net profit in 2010 Carrying amount € million	Favourable change € million	Unfavourable change € million
Derivative financial instruments	Discounted cash flow models	(11)	–	(2)
Banking derivatives	NAV multiples, EBITDA multiples, discount cash flow models, compounded interest	(30)	2	(5)
At 31 December		(41)	2	(7)

[24] NAV = net asset value; EBITDA = earnings before interest, tax, depreciation and amortisation.

Treasury debt securities and derivative financial instruments

The Bank's derivative instruments held within the Treasury portfolio are valued though discounted cash flow models. Valuations are reconciled to counterparty statements on a monthly basis. Therefore the reasonable possible alternative valuations have been determined based on the range of discrepancies between the Bank's valuations and those of our counterparties.

A majority of the Bank's debt securities are priced via a third party market data service, screen-based services such as Reuters and Bloomberg or using broker quotes. For the few debt securities where an active market does not exist, reasonable, alternative valuations have been derived from discounted cash flow models or reasonable adjustments to similarly priced assets.

Banking loans

Banking loans at fair value through profit or loss mainly comprise convertible loans or loans with an element of performance-based return. The valuation models/techniques used to fair value these instruments are discounted cash flow models and option pricing models. The inputs into the models include interest rates, the borrower's credit spreads and underlying equity prices. Reasonable possible alternative valuations have been determined based on the borrower's probability of default.

Banking share investments and derivatives

The Bank's unlisted equity portfolio comprises direct share investments, equity derivatives and equity funds. The main valuation models/techniques used to fair value these financial instruments are net asset value (NAV) multiples, earnings before interest, tax, depreciation and amortisation (EBITDA) multiples and discounted cash flow (DCF) models.

NAV multiples are most commonly applied to bank investments and equity funds. Reasonable possible alternative valuations have been determined based on the NAV multiple ranges in the valuations received for bank investments, and by considering the impact of adjusting the portfolio discount applied to equity funds. For investments valued using EBITDA multiples and DCF models, sensitivity analyses have been performed for the largest investments using reasonable possible alternative assumptions for each investment (for example, increase or decrease in the discount rate).

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 2011, the Bank's shareholders comprised 63 countries, together with the European Union (EU) 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 confirmed and supplemented 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

The Bank's activities are primarily Banking and Treasury. Banking activities represent investments in projects that, 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.

Information on the financial performance of Banking and Treasury operations is prepared regularly and provided to the chief operating decision maker. On this basis, Banking and Treasury operations have been identified as the operating segments.

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing the performance of the operating segments, is the President.

Segment performance
The President assesses the performance of the operating segments based on the net profit for the year, which is measured in a manner consistent with the financial statements. The segment information provided to the President for the operating segments for the year ended 31 December 2011 and 31 December 2010 is as follows:

	Banking 2011 € million	Treasury 2011 € million	Aggregated 2011 € million	Banking 2010 € million	Treasury 2010 € million	Aggregated 2010 € million
Interest income	859	187	1,046	645	131	776
Other (expense)/income	(282)	27	(255)	928	50	978
Total segment revenue	577	214	791	1,573	181	1,754
Less interest expense and similar charges[25]	(321)	(101)	(422)	(199)	(57)	(256)
Allocation of the return on capital	143	16	159	87	10	97
Less general administrative expenses	(234)	(15)	(249)	(214)	(14)	(228)
Less depreciation and amortisation	(20)	(1)	(21)	(21)	(1)	(22)
Segment result before provisions and hedges	145	113	258	1,226	119	1,345
Fair value movement on non-qualifying and ineffective hedges	–	(39)	(39)	6	(68)	(62)
Provisions for impairment of loan investments	(46)	–	(46)	94	–	94
Net profit for the year	99	74	173	1,326	51	1,377
Transfers of net income approved by the Board of Governors			–			(150)
Net profit after transfers approved by the Board of Governors			173			1,227
Segment assets						
Total assets	24,617	22,419	47,036	21,573	17,754	39,327
Segment liabilities						
Total liabilities	238	33,625	33,863	168	26,182	26,350

[25] The Bank's internal interest expense is determined by the rates at which Treasury can borrow funds on the external market. Interest expense is charged to Banking either at a benchmark rate of return for equity investments or at the appropriate base rate for loan investments.

Segment revenues – Geographic

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

Risk rating	Segment revenue 2011 € million	Segment revenue 2010 € million
Advanced countries[26]	(24)	267
Early/Intermediate countries[27]	435	460
Russia	136	830
Turkey	30	16
OECD (Treasury operations)	214	181
Total	791	1,754

Revenues are attributed to countries on the basis of the location in which a project operates.

3. Net interest income

	2011 € million	2010 € million
Interest and similar income		
Banking loans	859	645
Debt securities	134	95
Collateralised placements	9	–
Reverse repurchase agreements	9	8
Cash and short-term funds	32	16
Other	3	12
Interest and similar income	1,046	776
Interest expense and similar charges		
Debts evidenced by certificates	(177)	(91)
Other	(86)	(68)
Interest expense and similar charges	(263)	(159)
Net interest income	783	617

Interest income accrued on impaired financial assets at 31 December 2011 was €11 million (2010: €7 million).

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

[27] 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.

4. Net fee and commission income

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

	2011 € million	2010 € million
Trade finance fees	10	9
Administration fees	5	2
Syndication and agency fees	3	5
Other	3	2
Prepayment fees	1	3
Donor fund expenses	(2)	(2)
Net fee and commission income	20	19

Front-end and commitment fees of €109 million (2010: €112 million) received in 2011, together with related direct costs of €5 million (2010: €7 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 2011, €70 million (2010: €39 million) of previously deferred fees and direct costs were recognised in interest income.

5. Net (losses)/gains from share investments at fair value through profit or loss

	2011 € million	2010 € million
Net realised gains from share investments and equity related derivatives	162	338
Net unrealised (losses)/gains from share investments and equity related derivatives	(586)	512
Net (losses)/gains from share investments at fair value through profit or loss	(424)	850

6. Net gains/(losses) from loans at fair value through profit or loss

	2011 € million	2010 € million
Net unrealised gains/(losses) from changes in fair value	5	(7)
Net gains/(losses) from loans at fair value through profit or loss	5	(7)

7. Net losses/gains from Treasury assets held at amortised cost

	2011 € million	2010 € million
Net realised (losses)/gains from debt securities	(7)	1
Recoveries of previously recognised impairments on debt securities	2	10
Impairment losses from debt securities	(29)	(1)
Net losses/gains from Treasury assets held at amortised cost	(34)	10

During the year the Bank sold €349 million of debt securities held at amortised cost (2010: €237 million). These securities were sold in line with Treasury's investment policy to rebalance the duration of the portfolio by investing in longer dated securities or to reduce credit exposures with counterparties.

8. Net gains from dealing activities at fair value through profit or loss

	2011 € million	2010 € million
Debt buy-backs and termination of related derivatives	21	24
Internally managed dealing portfolio held for trading	36	25
Internally managed non-dealing debt securities at fair value	–	(11)
Externally managed dealing portfolio designated at fair value through profit or loss	–	2
Net gains from dealing activities at fair value through profit or loss	57	40

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

9. Other (losses)

Other (losses)/gains comprise the fair value movement on non-qualifying and ineffective hedges, as well as foreign exchange gains or losses. For the year, the Bank had a foreign exchange gain of €4 million (2010: loss of €1 million).

The hedging practices and accounting treatment are disclosed under "Derivative financial instruments and hedge accounting" in the Accounting policies section of the report.

Fair value movement on non-qualifying and ineffective hedges

The fair value movement on non-qualifying and ineffective hedges represents an accounting adjustment in respect of hedging relationships undertaken by the Bank that either do not qualify for hedge accounting or do not fully offset when measured in accordance with IFRS. This unrealised adjustment does not reflect economic substance, inasmuch as the reported losses would not be realised in cash were the hedging relationships to be terminated. The adjustment will reverse over time as the underlying deals approach their maturities.

The Bank applies hedge accounting where there is an identifiable, one-to-one relationship between a hedging derivative instrument and a hedged cash instrument. These relationships predominantly arise within the context of the Bank's borrowing activities in which the Bank's issued bonds are combined with swaps to achieve floating-rate debt in the currency sought by the Bank. While such hedges are matched in cash flow terms, accounting rules may require different valuation methodologies to be applied to such cash flows. In particular, a pricing component of currency swaps (known as the basis swap spread) is not applied to the related hedged bond. This component is a feature of supply and demand requirements for other currencies relative to the US dollar or euro. Such differences can create hedge ineffectiveness or hedge failures under IFRS, the combined effect of which is reported within this line of the income statement. For the year this resulted in a loss of €13 million (2010: loss of €55 million), comprising gains of €792 million (2010: gain of €1.1 billion) on the derivative hedging instruments and losses of €805 million (2010: €1.2 billion) on the hedged items.

In addition to the one-to-one hedge relationships for which the Bank applies hedge accounting, the Bank also hedges interest rate risk across total assets and liabilities on a portfolio basis, for which hedge accounting is not applied. This activity results in the gains or losses arising on the hedging derivative instruments being recognised in the periods in which they occur, while the offsetting impact deriving from the hedged cash instruments will accrue over a different timescale in keeping with the interest rates applicable to the specific periods for those instruments. For the year this resulted in a loss of €26 million (2010: loss of €13 million).

The combined effect of all the hedging activities described above was a loss of €39 million for the year (2010: loss of €61 million).[28] Together with the foreign exchange gain of €4 million, the total of 'other losses' for the year was €35 million (2010: €62 million).

Cash flow hedges

The Bank hedges on an annual basis to minimise the exchange rate risk associated with incurring administrative expenses in sterling. In 2011 and 2010 there was no ineffectiveness recognised in the income statement arising from cash flow hedges.

[28] The 2010 figure included a gain of €7 million from the closure of a hedge taken out in 2008 to lock in the interest rate return on the investment of the Bank's capital. This was taken out in anticipation of a fall in euro interest rates.

10. Provisions for impairment of Banking loan investments at amortised cost

(Charge)/release for the year	2011 € million	2010 € million
Portfolio provisions for the unidentified impairment of loan investments:		
Non-sovereign loan investments	(25)	118
Sovereign loan investments	(1)	–
Specific provisions for the identified impairment of loan investments[29]	(20)	(24)
Provisions for impairment of Banking loan investments at amortised cost	(46)	94

Movement in provisions	2011 € million	2010 € million
At 1 January	(630)	(719)
(Charge)/release for the year to the income statement	(46)	94
IFRS 9 release of prior year provisions for portage equities and loans at fair value through profit or loss	–	20
Unwinding of the discount relating to the identified impairment of assets	11	7
Foreign exchange adjustments	(12)	(39)
Release against amounts written off	5	7
At 31 December	(672)	(630)
Analysed between		
Portfolio provisions for the unidentified impairment of loan investments:		
Non-sovereign loan investments	(409)	(378)
Sovereign loan investments	(13)	(12)
Specific provisions for the identified impairment of loan investments	(250)	(240)
At 31 December	(672)	(630)

11. General administrative expenses

	2011 € million	2010 € million
Personnel costs	(173)	(160)
Overhead expenses	(81)	(75)
General administrative expenses	(254)	(235)
Release of deferral of direct costs related to loan origination and commitment maintenance	5	7
Net general administrative expenses	(249)	(228)

Sterling general administrative expenses totalled £213 million (2010: £200 million).[30]

Direct costs of €5 million (2010: €7 million) relating to loan origination in 2011, together with front-end and commitment fee receipts of €109 million (2010: €112 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 loans.

The following fees for work performed by the Bank's external auditor were included in overhead expenses. The figures for the prior year relate to the Bank's previous auditor:

Audit and assurance services	2011 € 000	2010 € 000
Services as auditor of the Bank	(231)	(262)
Internal controls framework assurance	(121)	(135)
Cooperation fund services	(136)	–
Retirement plan audit	(21)	(23)
Tax recovery audit	(7)	(8)
Audit and assurance services	(516)	(428)

[29] Comprises new specific provisions of €42 million against €22 million of released provisions (2010: €112 million against €88 million respectively).
[30] Excludes depreciation.

12. Placements with and advances to credit institutions

Analysed between	2011 € million	2010 € million
Cash and cash equivalents	4,450	2,814
Other current placements and advances	722	160
At 31 December	5,172	2,974

Cash and cash equivalents are those placements and advances which have a tenor equal to, or less than, three months. "Current" is defined as those assets maturing, or liabilities due, within the next 12 months. All other assets or liabilities are "non-current".

13. Debt securities

	2011 € million	2010 € million
Dealing portfolio at fair value through profit or loss		
Internally managed portfolio	411	439
Externally managed portfolio	–	298
At 31 December	411	737
Debt securities at amortised cost		
Debt securities	11,127	8,955
At 31 December	11,127	8,955
Debt securities at 31 December	11,538	9,692
Analysed between		
Current	5,900	8,047
Non-current	5,638	1,645
Debt securities at 31 December	11,538	9,692

	2011 € million	2010 € million
Cumulative impairment losses		
Carried forward balance	110	–
Impairment losses reclassified to amortised cost under IFRS 9	–	118
Balance at 1 January	110	118
Charge/(release) for the year	27	(9)
Amounts written off during the year	(102)	–
Foreign exchange movements	(1)	1
At 31 December	34	110

14. Collateralised placements

Analysed between	2011 € million	2010 € million
Current	226	343
Non-current	625	836
At 31 December	851	1,179

15. Other financial assets

	2011 € million	2010 € million
Fair value of derivatives designated as fair value hedges	4,209	3,345
Fair value of derivatives designated as cash flow hedges	14	–
Fair value of derivatives held for trading	455	250
Fair value of derivatives held in relation to the Banking portfolio	433	573
Interest receivable	253	192
Other	264	333
At 31 December	5,628	4,693

Analysed between	2011 € million	2010 € million
Current	1,210	769
Non-current	4,418	3,924
At 31 December	5,628	4,693

16. Banking loan investments at amortised cost

Operating assets	2011 Sovereign loans € million	2011 Non-sovereign loans € million	2011 Total loans € million	2010 Sovereign loans € million	2010 Non-sovereign loans € million	2010 Total loans € million
At 31 December 2009	–	–	–	2,264	10,861	13,125
IFRS 9 reclassification	–	–	–	–	(571)	(571)
At 1 January	2,341	12,902	15,243	2,264	10,290	12,554
Movement in fair value revaluation[31]	–	23	23	–	19	19
Disbursements	435	6,773	7,208	358	6,067	6,425
Repayments and prepayments	(362)	(4,140)	(4,502)	(337)	(3,813)	(4,150)
Foreign exchange movements	31	131	162	68	398	466
Movement in net deferral of front end fees and related direct costs	(5)	(35)	(40)	(12)	(52)	(64)
Written off	–	(6)	(6)	–	(7)	(7)
At 31 December	2,440	15,648	18,088	2,341	12,902	15,243
Impairment at 31 December	(13)	(659)	(672)	(12)	(618)	(630)
Total operating assets net of impairment at 31 December	2,427	14,989	17,416	2,329	12,284	14,613
Analysed between						
Current			3,145			2,602
Non-current			14,271			12,011
Total operating assets net of impairment at 31 December			17,416			14,613

At 31 December 2011 the Bank categorised 58 loans as impaired, with operating assets totalling €484 million (2010: 46 loans totalling €465 million).

[31] This movement in fair value relates to a hedge adjustment to fixed rate loans which qualify for hedge accounting for interest rate risk.

17. Banking loan investments at fair value through profit or loss

Non-sovereign loans	2011 € million	2010 € million
At 1 January	221	113
Disbursements	38	138
Repayments and prepayments	(41)	(26)
Movement in fair value revaluation	6	(7)
Foreign exchange movements	9	6
Movement in net deferral of front end fees and related direct costs	6	(3)
Fair value at 31 December	239	221
Analysed between		
Current	83	16
Non-current	156	205
At 31 December	239	221

18. Share investments at fair value through profit or loss

	2011 Fair value Unlisted € million	2011 Fair value Listed € million	2011 Fair value Total € million	2010 Fair value Unlisted € million	2010 Fair value Listed € million	2010 Fair value Total € million
Outstanding disbursements						
At 1 January	3,908	1,529	5,437	3,660	1,270	4,930
Transfer from unlisted to listed	–	–	–	(147)	147	–
Disbursements	945	143	1,088	800	128	928
Disposals	(409)	(45)	(454)	(380)	(14)	(394)
Written off	–	–	–	(25)	(2)	(27)
At 31 December	4,444	1,627	6,071	3,908	1,529	5,437
Fair value adjustment						
At 1 January	12	349	361	(134)	240	106
Transfer from unlisted to listed	–	–	–	60	(60)	–
Movement in fair value revaluation	129	(524)	(395)	86	169	255
At 31 December	141	(175)	(34)	12	349	361
Fair value at 31 December	4,585	1,452	6,037	3,920	1,878	5,798

At 1 January 2010, upon adoption of IFRS 9: Financial instruments for financial assets, share investments previously classified as portage equities or available-for-sale were reclassified to fair value through profit or loss.

Summarised financial information on share investments where the Bank owned greater than, or equal to, 20 per cent of the investee share capital at 31 December 2011, is detailed under note 30, “Related parties”.

19. Treasury share investments at fair value through other comprehensive income

Treasury holds a strategic share investment in The Currency Exchange Fund N.V. Through this investment the Bank can access the foreign currency hedging products offered by the fund and therefore it was deemed appropriate to designate this investment to be measured at fair value through other comprehensive income.

	2011 € million	2010 € million
Share investment designated at fair value through other comprehensive income		
The Currency Exchange Fund N.V.	58	56

There was no dividend income received on this share investment during 2011 (2010: €nil).

20. Intangible assets

	Computer software development costs 2011 € million	Computer software development costs 2010 € million
Cost		
At 1 January	149	138
Additions	14	11
At 31 December	163	149
Amortisation		
At 1 January	(102)	(85)
Charge	(17)	(17)
At 31 December	(119)	(102)
Net book value at 31 December	44	47

21. Property, technology and office equipment

	Property 2011 € million	Property under construction 2011 € million	Technology and office equipment 2011 € million	Total 2011 € million	Property 2010 € million	Property under construction 2010 € million	Technology and office equipment 2010 € million	Total 2010 € million
Cost								
At 1 January	43	3	27	73	40	3	27	70
Additions	1	2	1	4	2	1	1	4
Transfers	–	–	–	–	1	(1)	–	–
Disposals	(1)	–	(3)	(4)	–	–	(1)	(1)
At 31 December	43	5	25	73	43	3	27	73
Depreciation								
At 1 January	(15)	–	(20)	(35)	(12)	–	(19)	(31)
Charge	(3)	–	(1)	(4)	(3)	–	(2)	(5)
Disposals	1	–	3	4	–	–	1	1
At 31 December	(17)	–	(18)	(35)	(15)	–	(20)	(35)
Net book value at 31 December	26	5	7	38	28	3	7	38

22. Borrowings

	2011 € million	2010 € million
Amounts owed to credit institutions		
Current	(2,610)	(1,911)

23. Debts evidenced by certificates

The Bank's outstanding debts evidenced by certificates and related fair value hedging swaps are summarised below, both in the currency of the bond and the currency obtained after currency swap hedges have been taken into account.

	Adjusted principal value € million	Net currency obligations 2011 € million	Net currency obligations 2010 € million
Australian dollars	(2,156)	–	–
Canadian dollars	(217)	–	–
Euro	(2,053)	(7,037)	(5,725)
Japanese yen	(3,419)	(8)	(8)
Mexican peso	(53)	–	–
New Turkish lira	(1,040)	–	–
New Zealand dollars	(473)	–	–
Norwegian krone	(472)	–	–
Romanian leu	(39)	(4)	(4)
Russian roubles	(1,194)	(767)	(1,094)
South African rands	(875)	–	–
Sterling	(4,037)	(2,246)	(1,919)
Swedish krona	(1,109)	–	–
Swiss franc	(66)	–	
United States dollars	(11,992)	(19,133)	(14,286)
At 31 December	(29,195)	(29,195)	(23,036)

Where the swap counterparty exercises a right to terminate the hedging swap prior to legal maturity, the Bank is committed to exercise the same right with its issued bond.

Analysed between	2011 € million	2010 € million
Current	(6,267)	(5,674)
Non-current	(22,928)	(17,362)
Debts evidenced by certificates at 31 December	(29,195)	(23,036)

During the year the Bank redeemed €1.06 billion of bonds and medium-term notes prior to maturity (2010: €565 million), generating a net gain of €21 million (2010: €24 million).

24. Other financial liabilities

	2011 € million	2010 € million
Fair value of derivatives designated as fair value hedges	(1,298)	(768)
Fair value of derivatives designated as cash flow hedges	–	(3)
Fair value of derivatives held for trading	(264)	(271)
Fair value of other derivatives held in relation to the Banking portfolio	(81)	(30)
Interest payable	(227)	(188)
Other	(188)	(143)
At 31 December	(2,058)	(1,403)

Analysed between	2011 € million	2010 € million
Current	(728)	(340)
Non-current	(1,330)	(1,063)
At 31 December	(2,058)	(1,403)

25. Subscribed capital

	2011 Number of shares	2011 Total € million	2010 Number of shares	2010 Total € million
Authorised shared capital	3,000,000	30,000	2,100,000	21,000
of which				
Subscriptions by members – initial capital	992,615	9,926	992,175	9,922
Subscriptions by members – first capital increase	987,515	9,875	987,175	9,872
Subscriptions by members – second capital increase	857,828	8,579	99,978	999
Subscribed capital	2,837,958	28,380	2,079,328	20,793
Unsubscribed capital	162,042	1,620	20,672	207
At 31 December	3,000,000	30,000	2,100,000	21,000

The Bank's capital stock is divided into paid-in shares and callable shares. Each share has a par value of €10,000. At the Bank's Annual Meeting in May 2010, the Board of Governors approved a two-step increase in the authorised capital stock of the Bank: a €1.0 billion increase in authorised paid-in shares and a €9.0 billion increase in authorised callable capital shares, amounting to a €10.0 billion aggregate increase in the authorised capital stock of the Bank (collectively referred to as the second capital increase). Resolution No. 126 authorised the increase in authorised capital stock by 100,000 paid-in shares, each share having a par value of €10,000, taking the authorised capital stock of the Bank to €21.0 billion. Resolution No. 128 authorised the increase in the authorised capital stock of the Bank by 900,000 callable shares, each share having a par value of €10,000, with the shares subject to redemption in accordance with the terms of Resolution No. 128. The increase in callable capital became effective in April 2011.

Payment for the paid-in shares issued as part of the original authorised capital stock, and as part of the first capital increase and subscribed to by members, is made over a period of years determined in advance. Payment for the paid-in shares issued under the second capital increase was by way of a reallocation of net income previously allocated to surplus for other purposes, namely for the payment of such paid-in shares, pursuant to Article 36.1 of the Agreement and approved by Board of Governors Resolution No. 126, dated 14 May 2010. 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. The stability in the membership reflects the fact that the members are 63 countries[32] and two inter-governmental organisations, and that the purpose of the Bank is to foster the transition process in politically qualifying countries from central Europe to central Asia.

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, share 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 initial 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 first capital increase was made in eight equal annual instalments. Under Resolution No. 126, payment for the paid-in shares issued to members under the second capital increase was made in one instalment immediately following approval of Resolution No. 126.

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.

[32] Jordan and Tunisia became members in 2011.

Statement of capital subscription

At 31 December 2011	Total shares (number)	Resulting votes[33] (number)	Total capital € million	Callable capital € million	Paid-in capital € million
Members					
Albania	3,001	2,511	30	24	6
Armenia	1,050	1,050	11	8	3
Australia	30,014	30,014	300	237	63
Austria	68,432	68,432	684	541	143
Azerbaijan	2,101	2,101	21	15	6
Belarus	6,002	6,002	60	47	13
Belgium	68,432	68,432	684	541	143
Bosnia and Herzegovina	5,071	5,071	51	40	11
Bulgaria	16,598	16,598	166	117	49
Canada	102,049	102,049	1,020	807	213
Croatia	10,942	10,942	109	86	23
Cyprus	3,001	3,001	30	24	6
Czech Republic	25,611	25,611	256	203	53
Denmark	36,017	36,017	360	285	75
Egypt	2,101	2,101	21	15	6
Estonia	3,001	3,001	30	24	6
European Investment Bank	90,044	90,044	900	712	188
European Union	90,044	90,044	900	712	188
Finland	37,518	37,518	375	297	78
Former Yugoslav Republic of Macedonia	1,762	1,762	18	14	4
France	255,651	255,651	2,557	2,024	533
Georgia	3,001	1,012	30	24	6
Germany	255,651	255,651	2,557	2,024	533
Greece	13,656	13,656	137	96	41
Hungary	23,711	23,711	237	188	49
Iceland	3,001	3,001	30	24	6
Ireland	6,303	6,303	63	44	19
Israel	13,656	13,656	137	96	41
Italy	255,651	255,651	2,557	2,024	533
Japan	255,651	255,651	2,557	2,024	533
Jordan	100	100	1	1	–
Kazakhstan	4,832	4,832	49	34	15
Korea, Republic of	30,014	30,014	300	237	63
Kyrgyz Republic	2,101	1,010	21	15	6
Latvia	3,001	3,001	30	24	6
Liechtenstein	599	599	6	5	1
Lithuania	3,001	3,001	30	24	6
Luxembourg	6,002	6,002	60	47	13
Malta	210	210	2	1	1
Mexico	3,151	3,151	32	21	11
Moldova	3,001	2,308	30	24	6
Mongolia	210	210	2	1	1
Montenegro	420	420	4	3	1

[33] 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 2,837,958 (2010: 2,079,328).

Statement of capital subscription

At 31 December 2011	Total shares (number)	Resulting votes[34] (number)	Total capital € million	Callable capital € million	Paid-in capital € million
Morocco	1,050	1,050	11	7	4
Netherlands	74,435	74,435	744	589	155
New Zealand	1,050	1,050	11	7	4
Norway	37,518	37,518	375	297	78
Poland	38,418	38,418	384	304	80
Portugal	8,824	8,824	88	62	26
Romania	14,407	14,407	144	114	30
Russian Federation	120,058	120,058	1,201	951	250
Serbia	14,031	14,031	140	111	29
Slovak Republic	12,807	12,807	128	101	27
Slovenia	6,295	6,295	63	50	13
Spain	102,049	102,049	1,020	807	213
Sweden	68,432	68,432	684	541	143
Switzerland	68,432	68,432	684	541	143
Tajikistan	2,101	602	21	15	6
Tunisia	986	986	10	8	2
Turkey	34,515	34,515	345	273	72
Turkmenistan	210	164	2	1	1
Ukraine	16,808	16,808	168	118	50
United Kingdom	255,651	255,651	2,557	2,024	533
United States of America	210,104	210,104	2,101	1,475	626
Uzbekistan	4,412	4,134	44	31	13
Capital subscribed by members	2,837,958	2,831,872	28,380	22,181	6,199

[34] 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 2,837,958 (2010: 2,079,328).

26. Reserves and retained earnings

	2011 € million	2010 € million
Strategic reserve		
At 1 January	–	800
Transferred to paid-in capital	–	(800)
At 31 December	–	–
Special reserve		
At 1 January	306	273
Qualifying fees and commissions	–	33
At 31 December	306	306
Loan loss reserve		
At 1 January	753	778
Transferred from retained earnings	(77)	(25)
At 31 December	676	753
Net income allocation		
At 1 January	–	–
Transferred from retained earnings	210	–
At 31 December	210	–
General reserve – other reserve		
Revaluation reserve		
At 1 January	8	1,130
IFRS 9 reclassification of financial assets	–	(1,121)
Net gains arising on revaluation of share investments at fair value through other comprehensive income	2	(1)
At 31 December	10	8
Hedging reserve – cash flow hedges		
At 1 January	–	(15)
Gains from changes in fair value recognised in equity	15	16
Losses recycled to the income statement	–	(1)
At 31 December	15	–
Other		
At 1 January	189	184
Internal tax for the year	4	5
At 31 December	193	189
General reserve – other reserve at 31 December	218	197
General reserve – retained earnings		
At 1 January	5,524	4,504
Qualifying fees and commissions	–	(33)
Transferred to paid-in capital	–	(199)
Transferred from loan loss reserve	77	25
Transferred to net income allocation	(210)	–
Net profit after transfers of net income approved by the Board of Governors	173	1,227
General reserve retained earnings at 31 December	5,564	5,524
Total reserves and retained earnings at 31 December	6,974	6,780

In 2008 the Bank created a **strategic reserve** within members' equity to set aside a portion of net income to cover future capital requirements, other allocations and potentially to absorb any negative impact arising from adverse operational or financial developments. This reserve was eliminated in 2010, following approval by the Board of Governors of the Fourth Capital Resources Review (CRR4).

The **special reserve** is maintained, in accordance with Article 16 of 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. In 2011 the Board of Directors decided that the size of the special reserve was adequate and no additional fees were set aside (2010:€33 million).

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.

The **general reserve** represents all reserves except those amounts allocated to the strategic, special and loan loss reserves and it primarily comprises retained earnings. It also includes the retention of internal tax paid in accordance with Article 53 of the Agreement. This requires that all Directors, Alternate Directors, officers and employees of the Bank are subject to an internal tax imposed by the Bank on salaries and emoluments paid by the Bank and which is retained for its benefit. At the end of the year internal tax amounted to €84 million (2010: €79 million).

The **hedging reserve** includes forward exchange contracts entered into by the Bank to hedge part of its estimated future sterling operating expenditure. At 31 December there was €15 million unrealised mark-to-market gains on these contracts (2010: nil). These gains remain in reserves until such time as the related hedged expenditure is incurred.

Reserves and retained earnings	2011 € million	2010 € million
Special reserve	306	306
Loan loss reserve	676	753
Net income allocation	210	–
Unrealised gains	1,672	1,953
Total restricted reserves	2,864	3,012
Unrestricted general reserves	4,110	3,768
At 31 December	6,974	6,780

The Bank's reserves are used to determine, in accordance with the Agreement, what part of the Bank's net income will be allocated to surplus or other purposes and what part, if any, will be distributed to its members. For this purpose, the Bank uses unrestricted general reserves.

Article 36 of the Agreement relates to the allocation and distribution of the Bank's net income and states: "No such allocation, and no distribution, shall be made until the general reserve amounts to at least ten per cent of the authorised capital stock". This figure is currently €3.0 billion (2010: €2.1 billion).

At the 2011 Annual Meeting, the Board of Governors approved €120 million of net income to be allocated to Chernobyl Projects and in September approved an additional amount of €70 million. This is currently set aside in the Bank's restricted reserves and will be reflected in the income statement, below net profit, when the grant agreement is signed.

In addition to the above, the Board of Governors also approved an allocation of €20 million, comprising of €10 million each to the European Investment Bank and the International Bank for Reconstruction and Development, where these institutions contributed towards cooperation funds to be administered by the Bank to finance technical assistance in the SEMED region. This sum is currently set aside in the Bank's restricted reserves and will be reduced as expenses are incurred. The transfer of these funds does not qualify for derecognition from the Bank's balance sheet as the Bank retains the risks and rewards associated with the envisaged expenditure. The unspent cash from this allocation therefore continues to be included within the cash resources of the Bank while associated expenditure is recognised as expenses incurred by the Bank. As of 31 December, the Bank had incurred €0.4 million of gross expenses with respect to these activities, of which €0.2 million is reimbursable by the Cooperation Fund, equating to net expenses of €0.2 million.

27. Undrawn commitments and guarantees

Analysis by instrument	2011 € million	2010 € million
Undrawn commitments		
Loans	7,678	7,217
Share investments	1,803	1,712
At 31 December	9,481	8,929
Guarantees		
Trade finance guarantees[35]	465	369
Other guarantees[36]	88	96
At 31 December	553	465
Undrawn commitments and guarantees at 31 December	10,034	9,394

28. Operating lease commitments

The Bank leases its headquarters building in London and some of its Resident Office buildings in countries of operations. These are standard operating leases and include renewal options, periodic escalation clauses and 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 conducted in January 2007.

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

Payable	2011 € million	2010 € million
Not later than one year	28	27
Later than one year and not later than five years	101	98
Later than five years	131	153
At 31 December	260	278
Expenditure incurred in the current year	23	23

The Bank has entered into sub-lease arrangements for two floors of its headquarters building and the building previously used for the Kiev Resident Office. The total minimum future lease payments expected to be received under these sub-leases and income received during the year is shown below:

Receivable	2011 € million	2010 € million
Not later than one year	6	5
Later than one year and not later than five years	10	16
Later than five years	–	–
At 31 December	16	21
Income received in the current year	5	5

[35] Trade finance guarantees represent stand-by letters of credit issued in favour of confirming banks that have undertaken the payment risk of issuing banks in the Bank's countries of operations.
[36] Other guarantees include unfunded full or partial risk participations.

29. 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 the purposes of IAS 19: Employee Benefits, this is rolled forward annually to 31 December. The most recent valuation date was 30 June 2011. 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:

	2011 € million	2010 € million
Fair value of plan assets	220	199
Present value of the defined benefit obligation	(206)	(162)
	14	37
Unrecognised actuarial losses[37]	56	28
Prepayment at 31 December	70	65
Movement in the prepayment (included in "Other assets"):		
At 1 January	65	60
Exchange differences	2	2
Contributions paid[38]	17	17
Total expense as below	(14)	(14)
At 31 December	70	65
The amounts recognised in the income statement are as follows:		
Current service cost	(17)	(16)
Interest cost	(9)	(8)
Expected return on assets[39]	13	11
Amortisation of actuarial loss	(1)	(1)
Total included in staff costs	(14)	(14)

Principal actuarial assumptions used:

	2011	2010
Discount rate	4.50%	5.30%
Expected return on plan assets	5.00%	6.25%
Future salary increases	4.25%	4.75%
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	2011 € million	Expected return per annum	2010 € million	Expected return per annum
Equities	118	7.10%	118	8.20%
Index-linked bonds	82	2.50%	69	3.70%
Commodities	10	3.10%	11	4.20%
Derivatives	10	3.10%	–	n/a
Cash	–	0.50%	1	0.50%
Total	220		199	

[37] 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 an overall lower-than-expected investment return on plan assets, and a historical decline in the discount rate used to value the plan's liabilities.

[38] Contributions for 2012 are expected to be €16 million.

[39] The actual return on assets during the year was €8 million (2010: €20 million).

The approach used to determine the expected return on assets assumption is to set an assumption for the return on each of the main asset classes and then to weight these returns linearly according to the Plan's asset allocation. In this calculation, the return for bonds is assumed to be the same as their initial yields. At 31 December 2011, this is 3.1 per cent per annum for gilts and 2.5 per cent per annum for index-linked gilts. The expected return on equities is assumed to be 4.0 per cent above the return on gilts. It has been assumed that commodities and hedge funds have the same long-term expected return as gilts.

Changes in the present value of the defined benefit obligation	2011 € million	2010 € million
Present value of defined benefit obligation at 1 January	162	137
Service cost	18	16
Interest cost	9	8
Effect of exchange rate movement	4	6
Actuarial loss arising due to changes in assumptions	23	6
Benefits paid	(10)	(11)
Present value of defined benefit obligation at 31 December	206	162

Changes in the fair value of plan assets are as follows:	2011 € million	2010 € million
Opening fair value of plan assets	199	166
Expected return	13	11
Asset (loss)/gain arising during the year	(4)	9
Effect of exchange rate movement	4	7
Contributions paid	18	17
Benefits paid	(10)	(11)
Present value of plan assets at 31 December	220	199

History of experience gains and losses	2011 € million	2010 € million	2009 € million	2008 € million	2007 € million
Defined benefit obligation	206	162	137	108	126
Plan assets	220	199	166	100	154
Surplus/(deficit)	14	37	29	(8)	28
Experience gains/(losses) on plan liabilities:					
Amount	(16)	2	1	4	(4)
Percentage of the present value of the plan liabilities	(7.6%)	1.2%	1.1%	3.9%	(3.6%)
Actual return less expected return on plan assets:					
Amount	(4)	9	18	(29)	6
Percentage of the present value of the plan assets	(1.9%)	4.5%	11.0%	(29.5%)	3.9%

Defined contribution scheme

The charge recognised under the defined contribution scheme was €10 million (2010: €9 million) and is included in "General administrative expenses".

Other long-term employee benefits

The Bank introduced a medical retirement benefit plan on 1 June 2008 to provide staff retiring from the Bank, aged 50 or over and with at least seven years service, with a lump sum benefit to help purchase medical insurance cover. The total charge for the year calculated under IAS 19 was €1 million (2010: €1 million).

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30. Related parties

The Bank has the following related parties:

Key management personnel

Key management personnel comprise: the President and Vice Presidents; members of the Bank's Executive Committee; Director of the President's Office; Managing Directors; Corporate Directors; the Treasurer; the Controller; the Director of Human Resources; the Director, Communications; the Head of Internal Audit; and the Chief Compliance Officer.

In sterling terms, salaries and other benefits paid to key management personnel in 2011 amounted to £9 million (2010: £8 million). This comprises employee benefits of £7 million (2010: £7 million) and post-employment benefits of £2 million (2010: £1 million).

Two consultancy contracts which had been awarded in 2010 to a close family member of one of the Bank's key management personnel and which had an outstanding balance of €48,490 at 31 December 2010 were concluded and settled in 2011. No new contracts were awarded nor were any balances outstanding at 31 December 2011.

Venture capital associates

The Bank has a number of venture capital associates that it accounts for at fair value through profit or loss. At 31 December 2011, according to unaudited management information or the most recently audited financial statements from the investee companies, these venture capital associates had total assets of approximately €74.3 billion (2010: €66.0 billion) and total liabilities of approximately €49.3 billion (2010: €44.6 billion). For the year ended 31 December 2011, these associates had revenue of €23.1 billion (2010: €19.9 billion) and made a net profit of approximately €1.9 billion (2010: €2.1 billion).

In addition, the Bank has provided €115 million (2010: €128 million) of financing to these companies on which it received €3 million (2010: €4 million) of interest income during the year.

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 for each such Special Fund. At 31 December 2011 the Bank administered 17 Special Funds comprising fifteen Investment Special Funds, eight of which also contain a technical cooperation component, and two Technical Cooperation Special Funds.

The Bank acts as manager and administrator of the Special Funds. In its capacity as manager and administrator, the Bank receives management and cost recovery fees, which in 2011, amounted to €0.3 million (2010: €2 million).

The Bank pays for guarantees from certain Special Funds in respect of specific exposures arising in its loan and trade finance portfolios. During 2011 the Bank paid guarantee fees of €0.3 million (2010: €0.3 million). At 31 December 2011, the Bank recognised a receivable of €4 million (2010: €4 million) to reflect a potential recovery in relation to an impaired trade finance investment.

Summary of Special Funds

The financial statements of each Special Fund are approved separately by the Board of Governors. A summary of contributions pledged by each donor to, and a brief description of, each Special Fund is summarised below.

Audit fees payable to the Bank's auditor for the 2011 audits of the 17 Special Funds totalled €84,000 (2010: €98,000).

Summary of Special Funds

European Bank for Reconstruction and Development
Summary of Special Funds
Special Fund contributions pledged by donor

	Balkan Region Special Fund € 000	Baltic Investment Special Fund € 000	Central Asia Risk Sharing Special Fund € 000	EBRD CIF Special Fund € 000	EBRD Green Energy Special Fund € 000	EBRD Shareholder Special Fund € 000
Austria	276	–	–	–	–	–
British Petroleum	–	–	–	–	–	–
Canada	1,472	–	–	–	–	–
Clean Technology Fund	–	–	–	116,522	–	–
Denmark	750	571	–	–	–	–
EBRD Shareholders	–	–	–	–	–	295,000
EBRD Shareholder Special Fund	–	–	–	–	–	–
European Union (EU)	–	–	–	–	–	–
Finland	–	551	–	–	–	–
France	–	–	–	–	–	–
Germany	–	–	2,389	–	–	–
Iceland	–	27	–	–	–	–
Ireland	–	–	–	–	–	–
Italy	–	–	–	–	–	–
Japan	–	–	–	–	–	–
Korea	–	–	–	–	–	–
Luxembourg	–	–	–	–	–	–
Netherlands	–	–	–	–	–	–
Norway	1,568	494	–	–	–	–
Romania/EU	–	–	–	–	–	–
Russia Small Business Investment Special Fund	–	–	–	–	–	–
Spain	–	–	–	–	–	–
Strategic Climate Fund	–	–	–	810	–	–
Sweden	–	1,007	–	–	–	–
Switzerland	4,218	–	6,199	–	–	–
Taipei China	1,495	–	–	–	59,466	–
United Kingdom	–	–	–	–	–	–
United States of America	–	–	–	–	–	–
Total at 31 December	9,779	2,650	8,588	117,332	59,466	295,000

European Bank for Reconstruction and Development
Summary of Special Funds
Special Fund contributions pledged by donor (continued)

	EBRD SME Special Fund € 000	ETC Local Currency Risk Sharing Special Fund € 000	Financial Intermediary Investment Special Fund € 000	Italian Investment Special Fund € 000	Municipal Finance Facility Special Fund € 000	RDI Special Fund € 000
Austria	–	–	–	–	–	–
British Petroleum	–	–	–	–	–	3,874
Canada	–	–	–	–	–	–
Clean Technology Fund	–	–	–	–	–	–
Denmark	–	–	–	–	–	–
EBRD Shareholders	–	–	–	–	–	–
EBRD Shareholder Special Fund	–	10,100	–	–	–	–
European Union (EU)	–	–	–	–	33,000	–
Finland	–	155	–	–	–	–
France	–	–	–	–	–	–
Germany	–	78	–	–	–	–
Iceland	–	–	–	–	–	–
Ireland	–	71	–	–	–	–
Italy	–	–	–	21,024	–	–
Japan	–	568	–	–	–	–
Korea	–	117	–	–	–	–
Luxembourg	–	62	–	–	–	–
Netherlands	–	1,168	9,500	–	–	–
Norway	–	312	–	–	–	–
Romania/EU	–	–	–	–	–	–
Russia Small Business Investment Special Fund	–	–	–	–	–	–
Spain	–	310	–	–	–	–
Strategic Climate Fund	–	–	–	–	–	–
Sweden	–	210	–	–	–	–
Switzerland	–	236	–	–	–	–
Taipei China	–	108	34,571	–	–	–
United Kingdom	–	605	–	–	–	–
United States of America	33,393	3,747	847	–	–	–
Total at 31 December	33,393	17,847	44,918	21,024	33,000	3,874

European Bank for Reconstruction and Development
Summary of Special Funds
Special Fund contributions pledged by donor (continued)

	RMC Facility Special Fund € 000	Russia Small Business Investment Special Fund € 000	SME Finance Facility Special Fund € 000	Russia Small Business Technical Cooperation Special Fund € 000	EBRD Technical Cooperation Special Fund € 000	2011 Aggregated Special Funds € 000	2010 Aggregated Special Funds € 000
Austria	–	–	–	–	–	276	276
British Petroleum	–	–	–	–	–	3,874	3,920
Canada	–	2,706	–	4,309	–	8,487	8,049
Clean Technology Fund	–	–	–	–	–	116,522	53,555
Denmark	–	–	–	–	–	1,321	1,321
EBRD Shareholders	–	–	–	–	–	295,000	295,000
EBRD Shareholder Special Fund	–	–	–	–	–	10,100	–
European Union (EU)	–	–	191,390	–	–	224,390	229,673
Finland	–	–	–	–	–	706	551
France	–	7,686	–	4,980	–	12,666	11,705
Germany	–	9,843	–	3,025	–	15,335	13,890
Iceland	–	–	–	–	–	27	27
Ireland	–	–	–	–	–	71	–
Italy	–	8,402	–	1,360	–	30,786	30,073
Japan	–	21,162	–	3,295	–	25,025	22,676
Korea	–	–	–	–	–	117	–
Luxembourg	–	–	–	–	–	62	–
Netherlands	–	–	–	–	–	10,668	9,500
Norway	–	–	–	–	–	2,374	2,062
Romania/EU	18,020	–	–	–	–	18,020	18,020
Russia Small Business Investment Special Fund	–	–	–	8,848	–	8,848	3,392
Spain	–	–	–	–	–	310	–
Strategic Climate Fund	–	–	–	–	–	810	543
Sweden	–	–	–	–	–	1,217	1,007
Switzerland	–	2,360	–	1,244	–	14,257	13,897
Taipei China	–	–	–	–	–	95,640	21,240
United Kingdom	–	–	–	12,824	247	13,676	13,071
United States of America	–	7,192	–	29,695	–	74,874	73,720
Total at 31 December	18,020	59,351	191,390	69,580	247	985,459	827,168

The objectives of the Special Funds are as follows:

The Balkan Region Special Fund
To assist the reconstruction of Albania, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Montenegro, Romania and Serbia.

The Baltic Investment Special Fund
To promote private sector development through support for small and medium-sized enterprises in Estonia, Latvia and Lithuania.

The Central Asia Risk Sharing Special Fund
To provide a risk-sharing facility for SME credit lines, microfinance programmes, the Direct Investment Facility and the Trade Facilitation Programme in the Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan.

The EBRD CIF Special Fund
The Climate Investment Special Fund (CIF) provides resources in support of activities that promote low carbon technologies with significant potential for long-term greenhouse gas emissions savings and other climate change activities.

The EBRD Green Energy Special Fund
To support investment in green energy investment by the Bank's clients.

The EBRD Shareholder Special Fund
To assist the Bank's countries of operations by promoting transition towards open market-oriented economies.

The EBRD SME Special Fund
To assist the development of SMEs in Albania, Armenia, Azerbaijan, Bosnia and Herzegovina, Bulgaria, Croatia, FYR Macedonia, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Montenegro, Romania, Serbia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan.

The EBRD Technical Cooperation Special Fund
To serve as a facility for financing technical cooperation projects in countries of operations of the Bank.

The ETC Local Currency Risk Sharing Special Fund
To provide a risk-sharing facility for local currency lending in the Early Transition Countries (ETCs).

The Financial Intermediary Investment Special Fund
To support financial intermediaries in the countries of operations of the Bank.

The Italian Investment Special Fund
To assist the modernisation, restructuring, expansion and development of small and medium-sized enterprises in certain countries of operations of the Bank.

The 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.

The RDI Special Fund
The Regional Development Initiative (RDI) provides a long-term contribution to sustainable socio-economic development across Azerbaijan and Georgia.

The RMC Facility Special Fund
To improve access to finance for micro and small enterprises in Romania through the Romania Micro Credit (RMC) Facility.

The Russia Small Business Investment Special Fund
To assist the development of small businesses in the private sector in Russia.

The Russia Small Business Technical Cooperation Special Fund
To assist the development of small businesses in the private sector in Russia.

The SME Finance Facility Special Fund
To alleviate the financing problems of small and medium-sized enterprises in Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic and Slovenia.

31. Other fund agreements

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

The table below provides a summary of these Funds.

	2011 Amount per agreements € million	2011 Contributions received € million	2011 Cumulative No. of Funds	2010 Amount per agreements € million	2010 Contributions received € million	2010 Cumulative No. of Funds
Technical Cooperation Funds	1,989	1,769	229	1,692	1,502	205
Investment Cooperation Funds	258	211	30	258	205	30
Carbon Fund	231	153	3	231	150	3
Project Specific Assignments	61	57	92	61	57	92
EU Pre-accession Preparation Funds	35	35	2	35	35	2
Total	2,574	2,225	356	2,277	1,949	332

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 safety improvement measures.

At their Denver Summit in June 1997, the G-7 countries and the European Union 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 of Directors. 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.

In 1999, in pursuit of their policy to accede to the European Union, 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 10 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 that are a consequence of the closure decisions.

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.

The table below provides a summary of these funds.

	2011 Contributions pledged € million	2011 No. of Contributors	2010 Contributions pledged € million	2010 No. of contributors
Nuclear Safety Account	334	17	322	17
Chernobyl Shelter Fund	1,000	25	841	24
Ignalina IDSF	697	16	697	16
Kozloduy IDSF	733	11	658	11
Bohunice IDSF	497	9	435	9
NDEP	339	12	312	12

For all of the above funds with the exception of NDEP, pledges are calculated using the fixed exchange rate defined in the rules of the relevant fund.

Audit fees payable to the Bank's auditor for the 2011 audits of the cooperation and nuclear safety funds totalled €0.4 million (2010: €0.4 million). An additional amount of €0.1 million was paid in respect of one consultancy contract with a termination date in May 2012.

32. Post-balance sheet events

There have been no material post-reporting date events that would require disclosure or adjustment to these financial statements.

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.

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 auditor during its audit were valid and appropriate. The external auditor's report accompanies the audited financial statements.

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

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

The Bank's Board of Directors has appointed an Audit Committee, which assists the Board in its responsibility to ensure the soundness of the Bank's accounting practices and the effective implementation of the internal controls that management has established relating to finance and accounting matters. The Audit Committee is comprised entirely of members of the Board of Directors. The Audit Committee meets periodically with management in order to review and monitor the financial, accounting and auditing procedures of the Bank and related financial reports. The external auditor and the internal auditor regularly meet with the Audit Committee, with and without other members of management being present, to discuss the adequacy of internal controls over financial reporting and any other matters 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 2011. Management's assessment includes the Special Funds and other fund agreements referred to in Notes 30 and 31 of the *Financial Report 2011*, and the retirement plans. However, the nature of the assessment is restricted to the controls over the reporting and disclosure of these funds within the Bank's financial statements, 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 controls over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission. Based upon this assessment, management asserts that at 31 December 2011 the Bank maintained effective internal controls over its financial reporting as contained in the *Financial Report 2011*.

The Bank's external auditor has provided an audit opinion on the fairness of the financial statements presented within the *Financial Report 2011*. In addition, it has issued an attestation report on management's assessment of the Bank's internal control over financial reporting, as set out on page 78.

Thomas Mirow
President

Manfred Schepers
Vice President, Finance and Chief Financial Officer

European Bank for Reconstruction and Development
London
28 February 2012

Report of the independent auditor

To the Governors of the European Bank for Reconstruction and Development

We have examined 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 2011*, based on the criteria for effective internal controls over financial reporting described in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organisations of the Treadway Commission. Management is responsible for maintaining effective internal controls over financial reporting and for the assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assertion over the effectiveness of the Bank's internal control over financial reporting, based on our examination.

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

A bank's internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A bank's internal controls over financial reporting include those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the bank; (2) provide reasonable assurance that the transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the bank are being made only in accordance with the authorisation of the bank's management; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the bank's assets that could have a material effect on the financial statements.

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

In our opinion, management's assertion that the Bank maintained effective internal control over financial reporting, included within the Responsibility for external financial section of the Bank's Financial Report for the year ended 31 December 2011, 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 Committee of Sponsoring Organisations of the Treadway Commission.

This report, including the opinion, has been prepared for, and only for, the Board of Governors as a body in connection with management's attestation for maintaining effective internal controls over financial reporting 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.

Deloitte LLP

Deloitte LLP
Chartered Accountants
London, United Kingdom
28 February 2012

Independent auditor's 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 2011 which comprise the income statement, the statement of comprehensive income, the balance sheet, the statement of changes in equity, the statement of cash flows, the accounting policies, the related notes 1 to 32 and the risk management statement. The financial reporting framework that has been applied in their preparation is International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board.

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 for such internal control as the President determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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 2011 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.

Other reporting responsibilities

We also report to you if, in our opinion, the financial results section of the *Financial Report 2011* is not consistent with the Financial Statements, if the proper accounting records for the Bank have not been kept, 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 2011* 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.

We have nothing to report to you in connection with these matters.

Other matters

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.

Deloitte LLP

Deloitte LLP
Chartered Accountants
London, United Kingdom

28 February 2012

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