European Bank
for Reconstruction and Development

FINANCIAL REPORT 2017

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The *Financial Report 2017* 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 a multilateral bank, owned by 66 countries as well as the European Union and the European Investment Bank. It promotes the development of the private sector and entrepreneurial initiative in 38 economies, across three continents. The Bank's investments are aimed at making the economies in its regions competitive, inclusive, well governed, green, resilient and integrated.

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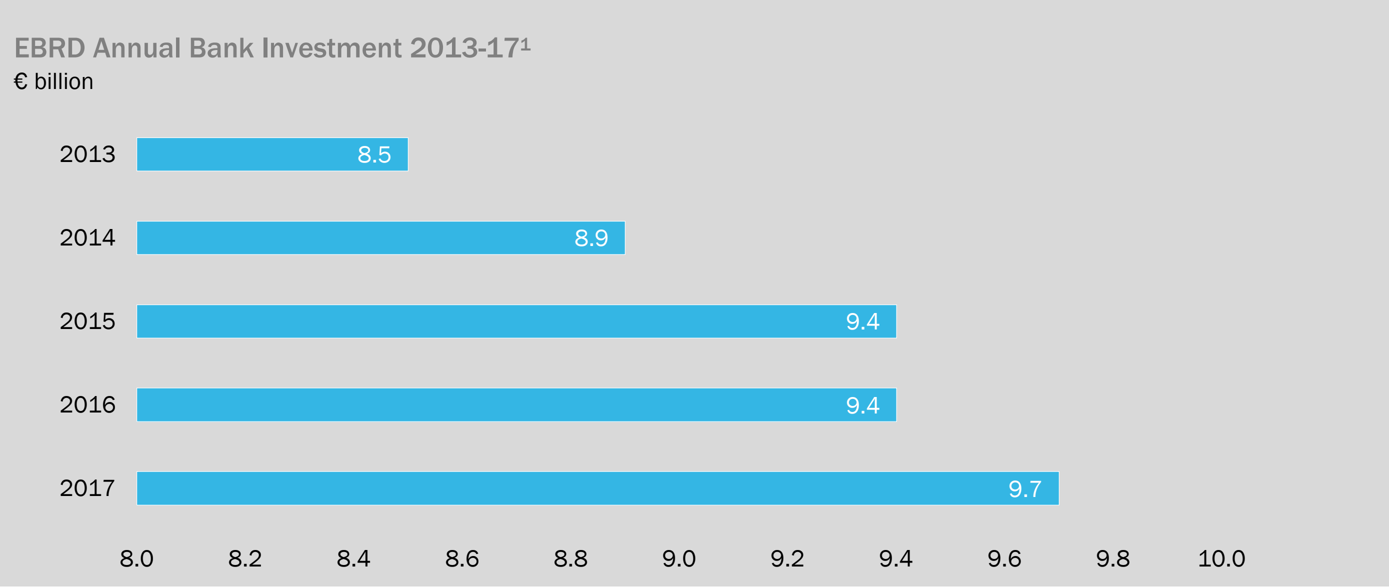
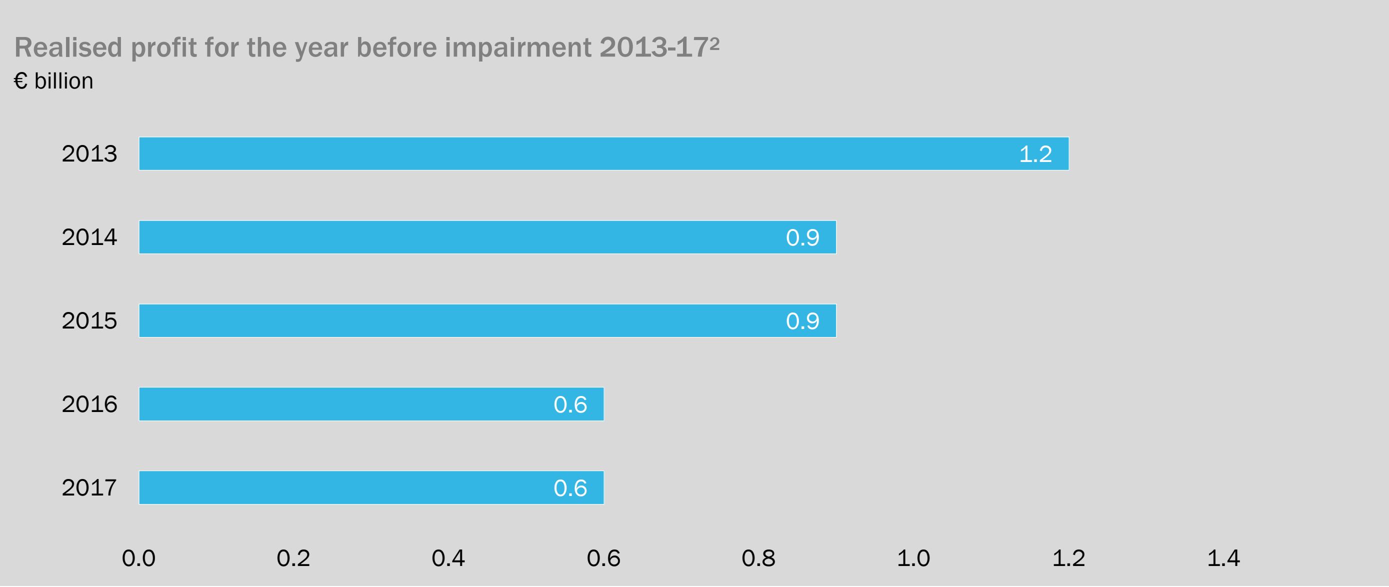
Highlights





[1] Volume of commitments made by the Bank during the year. This includes (i) new commitments (less any amount cancelled or syndicated within the year); (ii) restructured commitments; and (iii) trade finance (TFP) amounts issued during the year and outstanding at year-end.

[2] Realised profit before impairment is before unrealised fair value adjustments to share investments, provisions, loan write-offs, other unrealised amounts and transfers of net income.

Financial results 2013-17

€ million	2017	Restated[3] 2016	Restated 2015	2014	2013
Net profit/(loss) before transfers of net income approved by the Board of Governors	772	992	802	(568)	1,012
Transfers of net income approved by the Board of Governors	(180)	(181)	(360)	(155)	(90)
Net profit/(loss) after transfers of net income approved by the Board of Governors	592	811	442	(723)	922
Realised profit before impairment	634	649	949	927	1,169
Paid-in capital	6,211	6,207	6,202	6,202	6,202
Reserves and retained earnings	9,961	9,351	8,504	7,947	8,674
Total members' equity	16,172	15,558	14,706	14,149	14,876

Operational results 2013-17

	2017	2016	2015	2014	2013
Number of projects[4]	412	378	381	377	392
Annual Bank Investment (€ million)	9,670	9,390	9,378	8,853	8,498
Annual mobilised investment[5] (€ million)	1,054	1,693	2,336	1,177	862
of which Private Direct Mobilisation	669	1,401	2,138	1,014	769
Total project value[6] (€ million)	38,439	25,470	30,303	20,796	20,527

[3] As explained in note 32 on page 80.

[4] The number of projects to which the Bank made commitments in the year.

[5] The annual mobilised investment measure was first introduced in 2014. Figures for 2013 comprise syndicated loans and EBRD-administered Special Fund amounts only. Annual mobilised investment is the volume of commitments from entities other than the Bank made available to the client due to the Bank's direct involvement in mobilising external financing during the year.

[6] 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 Bank Investment" 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 EBRD recorded a net profit from continuing operations of €772 million, a reduction from the €992 million profit recorded for 2016.[7] The main contributing factors behind this profit were interest income of €754 million, roughly in line with 2016; and equity gains of €332 million, a reduction on the €423 million recorded in 2016 owing to lower unrealised fair value gains. The other key difference to 2016 was also due to unrealised factors, with a net loss of €20 million from net hedge ineffectiveness in 2017 compared with gains of €131 million in 2016. These movements are attributable to an accounting adjustment so are not considered to have economic substance and will reverse over time.[8] As the main differences to the Bank's 2016 profits were due to unrealised factors, the realised profit in 2017 of €634 million was comparable with that recorded in 2016.

There were no net provisioning losses in the year, and the volume of non-performing loans improved to 3.9 per cent of total loans, from 5.5 per cent in 2016 as a result of repayments, write-offs, and the return of some loans to performing status.

Allowing for income allocations of €180 million[9] the Bank's reserves increased from €9.4 billion at the end of 2016 to €10.0 billion at the end of 2017. The EBRD continues to be rated AAA, and was reaffirmed as such by all three major rating agencies in 2017.

[7] 2016 balances are restated as explained in note 32 on page 80.

[8] See note 9 on page 61 for a more detailed explanation.

[9] Income allocations are approved by the Bank's Board of Governors.

Bank operations

Operational results

Annual Bank Investment[10] amounted to a record level of €9.7 billion,[11] in 2017, comprising 412 investment operations,[12] another record, and activity in 76 trade finance agreements under the Trade Facilitation Programme (2016: €9.4 billion, 378 investment operations and 74 trade finance agreements).

The EBRD invested in 36 countries in 2017 with investment by region as follows: €2.2 billion in the southern and eastern Mediterranean (SEMED); €1.8 billion in eastern Europe and the Caucasus; €1.5 billion in Turkey; €1.4 billion in south-eastern Europe; €1.2 billion in central Europe and the Baltic states; €0.9 billion in central Asia; and €0.7 billion in Cyprus and Greece combined.

The EBRD continued to support key economic sectors in line with its operational strategy. In 2017, Annual Bank Investment in the financial sector reached close to €2.9 billion, with priority given to financing small and medium-sized enterprises (SMEs). A further €2.5 billion was invested in the infrastructure sector, €2.2 billion in the diversified corporate sectors, and €2.0 billion in the energy sector.

The Bank's portfolio of investment operations (including undisbursed commitments) decreased from €41.8 billion in 2016 to €41.4 billion by the end of 2017. In addition to reflows on existing investment operations, the Bank's portfolio which is reported in euros was impacted by the strengthening of the euro during 2017 (€/$1.06 at end 2016 compared with €/$1.20 at end 2017) resulting in a decrease in the euro value of the Bank's US dollar denominated assets.

Gross disbursements reached €6.2 billion in 2017, a decrease on the 2016 level of €7.8 billion. Loan repayments of €4.6 billion (2016: €6.0 billion) and equity divestments of €1.0 billion (2016: €0.7 billion) resulted in operating assets[13] of €28.7 billion at end 2017, down from €29.7 billion at the end of 2016 due in large part to the variation in the €/$ exchange rate. Operating assets comprised €23.2 billion of disbursed outstanding loans (2016: €23.5 billion) and €5.5 billion of disbursed outstanding equity investments at historic cost (2016: €6.1 billion) at 31 December 2017.

In addition to Annual Bank Investment (own account), direct mobilisation reached €1.1 billion, of which €0.7 billion was from the private sector, principally through syndicated loans, and €0.4 billion from the public sector. The Bank also attracted a further €0.2 billion of unfunded risk participations to its projects from the private sector.

Total external financing (finance directly mobilised by the EBRD plus additional investment attracted by projects the Bank invested in) on signed EBRD projects increased from €17.4 billion in 2016 to €29.2 billion in 2017. The increase in external financing was driven by bilateral/multilateral financing and non-Bank financiers.

The Bank's activities in 2017 remained strongly supported by donor funding, including the Special Funds programme and the Cooperation Funds. These broad-based results reflect an ongoing commitment to the transition of countries in the EBRD region as they build and strengthen open market economies.

Financial performance

Banking operations recorded a net gain of €703 million[14] for 2017, roughly equivalent to the gain of €731 million for 2016. The Banking profit for the year is primarily attributable to €754 million gains from net interest income and €332 million gains from the Bank's equity investments. In comparison to 2016, a €54 million reduction in provisioning charges on Banking loans was offset by a €92 million reduction in gains from equity investments. The contribution from share investments is expected to continue to show significant variability from year to year, given the volatility of equity markets.

Treasury operations

Portfolio

The value of assets under Treasury management at 31 December 2017 was €25.0 billion (2016: €24.0 billion) and borrowings were €37.8 billion (2016: €38.0 billion). The size of Treasury's balance sheet is primarily driven by the requirements of the Bank's internal liquidity policies while fluctuations in foreign exchange rates, in particular the euro against the United States dollar, also has an impact on stated figures. The funding programme of 2017 was completed as planned with the Bank raising medium- and long-term debt of €8.2 billion (2016: €5.6 billion).

Financial performance

Before allowing for the impact of hedge accounting adjustments, Treasury returned a profit of €89 million in 2017 compared with the €130 million gain in 2016. Treasury's performance is internally evaluated before the hedge accounting adjustment which is considered an accounting technicality.[15] After allowing for hedge accounting adjustments Treasury's operating profit for 2017 was €69 million (2016: €261 million profit). Treasury's performance is primarily driven by the generation of net interest income and the mark-to-market valuations of derivatives used to manage interest rate and currency risks in the Bank's balance sheet.

[10] Commitments made by the Bank in the year to finance investment operations, including to restructured operations, less cancellations or sales of such commitments with the same year.

[11] As region/sector amounts and disbursements/repayments are individually reported to one decimal point, the sum of these amounts may create a rounding difference with the Annual Bank Investment total.

[12] The Bank's loans and equity investments at cost together with undrawn commitments.

[13] Operating assets are the total amounts disbursed less reflows. They do not include accounting fair value adjustments or the deferral of fees associated with the origination of amortised cost assets.

[14] See note 2 on page 58 for further detail.

[15] See note 9 on page 61 for a more detailed explanation.

Capital

The Bank's authorised share capital is €30.0 billion, subscribed capital €29.7 billion and paid-in capital €6.2 billion. This is materially unchanged from 31 December 2016.

The calculation of capital for gearing purposes under the Agreement Establishing the Bank is explained under the Capital Management section of this report on page 52.

Reserves

The Bank's reserves increased from €9.4 billion at the end of 2016 to €10.0 billion at the end of 2017.

Expenses

General administrative expenses for 2017, inclusive of depreciation and amortisation, were €421 million (2016: €467 million). The decrease is mainly due to the lower conversion rate from pound sterling, in which expenses are predominantly incurred, into euro, reflecting the rate at which the Bank hedged its 2017 budget at the end of 2016. The pound sterling equivalent of this figure was £362 million (2016: £343 million). £13 million of the increased expenditure relates to costs under the Bank's Operational Effectiveness and Efficiency Programme, with the remainder mostly related to increases in staff costs.

Outlook for 2018

The Bank expects its net realised profit to remain relatively stable. However geopolitical uncertainty in the Bank's region of operations will continue to contribute to volatility in the Bank's earnings, particularly in the valuations of its equity portfolio and the level of provisioning against its loan book.

Key financial indicators 2013-17

Key financial indicators are presented for the Bank over the last five years. These ratios are influenced by the growth in portfolio and Annual Bank Investment over 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 MDBs in terms of capital strength and cost efficiency.

The Bank's profits and reserves show volatility due, in particular, to movements in the valuations of share investments. Excluding these movements – together with unrealised fair value movements on Banking loans also measured at fair value – the Bank continues to grow its members' equity, achieving an average return on equity of 5.3 per cent over the last five years (2012-16: an average of 5.7 per cent). The Bank's non-performing loan ratio decreased to 3.9 per cent at 31 December 2017 from 5.5 per cent a year earlier.

In terms of cost efficiency, the cost-to-income ratio has increased to 35.3 per cent in 2017 compared with 30.7 per cent a year earlier. This mainly reflects lower profit, in particular, from share investments and fair value movements on non-qualifying and ineffective hedges. The Bank monitors this metric on a five-year rolling average basis due to the high degree of volatility in the valuations of share investments. The 2017 five-year rolling average was 36.4 per cent (2016: 32.7 per cent).

Leverage – debt divided by members' equity – has decreased to 2.3 times at 31 December 2017 (2016: 2.4 times), reflecting the growth in the Bank's reserves.

The Bank's capital strength is illustrated by the level of members' equity, which represented 28.8 per cent of total assets at 31 December 2017 (2016: 27.6 per cent), including Treasury assets with an average risk rating between AA and AA- with an average maturity of 1.4 years (2016: 1.3 years). Members' equity represented 60.0 per cent of Banking assets (development-related exposure) at 31 December 2017 (2016: 56.4 per cent). The Bank's capital strength and strong liquidity position is further reflected in its AAA rating with a stable outlook affirmed by all three major rating agencies in 2017.

	2017	Restated 2016	Restated 2015	2014	2013
Financial performance					
1. Return on members' equity – net profit basis	5.1%	7.0%	6.5%	(3.8%)	7.2%
2. Return on members' equity – realised after provisions	4.8%	4.7%	5.7%	3.1%	8.1%
Efficiency					
3. Cost-to-income ratio	35.3%	30.7%	38.8%	157.8%	23.1%
Portfolio quality					
4. Non-performing loans ratio	3.9%	5.5%	5.9%	5.6%	3.3%
5. Average rating of Treasury liquid assets	2.3	2.3	2.2	2.3	2.3
6. Average maturity of Treasury liquid assets (tenor in years)	1.4	1.3	1.3	1.5	1.2
Liquidity and leverage					
7. Liquid assets/undisbursed Banking investments plus one-year debt service	91.6%	91.4%	92.5%	103.1%	93.5%
8. Debt/members' equity: leverage ratio	233.7%	244.5%	250.9%	250.6%	209.7%
Capital strength					
9. Members' equity/total assets	28.8%	27.6%	26.7%	26.9%	30.3%
10. Members' equity/Banking assets	60.0%	56.4%	56.3%	57.6%	58.6%

Explanatory notes on ratios above

1. (Total closing members' equity minus total opening members' equity) divided by total opening members' equity. The total closing members' equity is before net income allocations and capital subscriptions accounted for during the year.
2. (Total closing members' equity minus total opening members' equity) divided by total opening members' equity. The unrealised Banking fair value reserves are excluded from both the total closing and opening members' equity. The total closing members' equity is also adjusted for net income allocations and capital subscriptions accounted for during the year.
3. Total administrative expenses (including depreciation and amortisation) divided by total operating income before provisions for impairment but including all fair value movements on both Banking and Treasury investments.
4. Total non-performing loans as a percentage of total loan operating assets.
5. Represents the average credit rating weighted by Treasury liquid assets for 2013 to 2017, based on the Bank's internal rating scale on page 29. The rating methodology for covered bonds changed in 2015, improving the ratio from 2.4 to 2.2.
6. The average tenor of Treasury assets in years is derived from the weighted average time to final maturity, with the exception of asset-backed securities (ABS) 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, which comprises debt due for redemption within one year and one year's estimated interest expense. From 2016, debt redemptions have been based on expected rather than contractual maturity.
8. Total borrowings divided by total members' equity.
9. Total members' equity (adjusted for paid-in capital receivable) divided by total assets.
10. Total members' equity (adjusted for paid-in capital receivable) divided by total net book value of Banking assets.

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 68 members. 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 members. 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 2017 is detailed in the digital version of the *Annual Review* (www.ar-ebrd.com).

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.

Primary Management Committees

Listed below are the committees that directly advised the President or a member of the Executive Committee on the overall management of the Bank during 2017.

Management Committees	Chair	Purpose of the Committee	Meeting frequency
Executive Committee	President	Advises the President on all aspects of bank-wide strategic significance, with the exception of matters that fall within the competence of other management committees, as defined in their terms of reference.	Monthly
Management Committee	Senior Vice President, Chief Financial Officer and Chief Operating Officer	Considers bank-wide operational and administrative matters.	Fortnightly
Operations Committee	First Vice President and Head of Client Services	Considers matters related to the Bank's investment operations.	Weekly
Strategy and Policy Committee	Vice President, Policy and Partnerships	Considers matters that fall within the overall responsibility of the Vice President, Policy and Partnerships; and certain matters falling within the responsibility of the Chief Economist. It focuses primarily on transition, strategy and policy work: country, sector and thematic strategies and policy-related research.	Fortnightly
Risk Committee	Vice President, Risk and Compliance and Chief Risk Officer	Considers matters that fall within the responsibility of the Vice President, Risk and Compliance, Chief Risk Officer, such as Bank-wide risks, including credit and operational risk, with associated follow-up actions. It oversees risk aspects of the Banking and Treasury portfolios (for example stress testing), approves risk policies and risk reports and considers new Banking/Treasury products.	Fortnightly
Asset and Liability Committee	Senior Vice President, Chief Financial Officer and Chief Operating Officer	Considers matters that fall within the overall accountability of the Senior Vice President, Chief Financial Officer, Chief Operating Officer in his/her capacity of supervising Treasury activities and liquidity management at the Bank: areas of liquidity policy and management, funding and other Treasury activities, including monitoring business plan implementation, limit compliance and hedging strategy implementation.	Quarterly
Equity Committee	First Vice President and Head of Client Services	Maintains oversight of listed and unlisted share investments. Reviews and identifies suitable exit opportunities and makes recommendations on such exits to the Operations Committee.	Quarterly
Crisis Management Team	Vice President and Chief Administrative Officer	Prepares coordinated responses 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 and business recovery plans are in place and are tested on a regular basis.	At least two times per year
Information Technology Governance Committee	Vice President and Chief Administrative Officer	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
Procurement Complaints Committee	Deputy General Counsel, Corporate	Considers complaints and disputes arising from tendering and contracts for goods, works and consultant services (including those funded by cooperation funds or the Special Funds resources), subject to the Procurement Policies and Rules of the Corporate Procurement Policy. Reviews procurement and related matters referred to it by the Executive Committee.	As necessary

EBRD Codes of Conduct

The EBRD has a Code of Conduct for Officials of the Board of Directors and a separate Code of Conduct for Bank Personnel, which, respectively, articulate the values, duties and ethical standards the Bank expects of its Board officials and staff. These Codes were last revised, with approval of the Bank's Board of Governors, in February 2012. In accordance with the five-year review cycle, a review of both Codes of Conduct commenced in 2017 and is expected to conclude in the first half of 2018. The Codes of Conduct can be obtained at www.ebrd.com/integrity-and-compliance.html

Compliance

The EBRD's Office of the Chief Compliance Officer (OCCO) has been established as a function that is independent of the Bank's operational departments. It is headed by a Chief Compliance Officer (CCO) who reports functionally to the President and has full and free access to the Chair of the Audit Committee. Any decision to remove the CCO (other than for misconduct) shall be taken by the President in accordance with guidance given by the Board of Directors in an Executive Session.

OCCO's mission is to protect the integrity and reputation of the Bank, to promote ethical standards of behaviour and to strengthen the Bank's accountability and transparency. OCCO assists in identifying, assessing, and monitoring integrity risks arising from failure to comply with the Bank's standards and policies, and contributes, in an independent manner, to the Bank's effective management of such risks. OCCO is also responsible for the development and maintenance of the policies and standards it enforces. The EBRD's Integrity Risks Policy and Terms of Reference for OCCO, last revised on 16 November 2016, and available at www.ebrd.com/downloads/integrity/integrityriskpol.pdf sets out, for the benefit of the Bank's stakeholders, the manner in which OCCO helps the Bank to protect its integrity and reputation and to manage integrity risks related to clients and personal conduct related risks.

Financial and integrity due diligence are integrated into the Bank's normal approval of new business and in the monitoring of its existing operations. OCCO provides independent expert advice to management on significant integrity concerns and assesses whether the potential risk is acceptable to the Bank. It monitors the integrity due diligence information provided by the Banking Department to ensure that it is accurate and that integrity concerns are properly identified and, where possible, mitigated.

OCCO is further responsible for investigating allegations of staff misconduct as well as allegations of fraud and corruption in relation to Bank projects and counterparties. Allegations of staff misconduct are investigated under the Conduct and Disciplinary Rules and Procedures (CDRPs), most recently revised to reflect, among other things, the change in the Bank's approach to handling complaints of inappropriate behaviour and the division of responsibility between the CCO as fact-finder and the Managing Director, Human Resources as decision-maker. The CDRPs specify the rights and duties of both the Bank and staff member in question during the investigative and disciplinary processes and provide safeguards for the subject of the investigation. Allegations of misconduct on the part of Board Officials on the one hand, and on the part of the President, Vice Presidents, Chief Evaluator and the CCO on the other, are dealt with in accordance with the provisions of the Code of Conduct for EBRD Board Officials or the Code of Conduct for EBRD Personnel, respectively.

Allegations of fraud and corruption in relation to activities and projects financed from the Bank's ordinary capital resources (including the purchase of goods, works or services for the Bank) or from Special Funds resources, or from cooperation funds administered by the Bank, are investigated under the Bank's Enforcement Policy and Procedures (EPPs).

The EPPs were significantly revised in 2015 and further updated in October 2017. While updates in 2017 were largely non-substantive, the 2015 revisions include the creation of a two-tier decision-making process, the introduction of a settlement process and streamlining the procedures for referring matters to national authorities. In addition, the revised EPPs introduced two new sanctionable practices, namely obstruction and misuse of Bank resources. The EPPs also describe the process by which the Bank applies sanctions imposed by other multilateral development banks pursuant to the Agreement for the Mutual Enforcement of Debarment Decisions. Details of the individuals, entities and sanctions are posted at www.ebrd.com/ineligible-entities.html.

OCCO is also responsible for training Bank personnel in relation to the Bank's integrity, anti-money-laundering and counter-terrorist finance requirements. In addition, it provides specialist training and advises, as necessary, individuals who are nominated by the Bank to serve as directors on the boards of companies in which the Bank holds an equity interest.

The Bank has an accountability mechanism that assesses and reviews complaints about Bank-financed projects and provides, where warranted, a determination as to whether the Bank acted in compliance with relevant policies when it approved a particular project. The mechanism also has a problem-solving function which can serve to restore dialogue between the project sponsor and members of the affected community. The Project Complaint Mechanism (PCM) is administered by a dedicated PCM Officer. The role of the CCO, as the head of the Office in which the PCM is located, is limited to ensuring that the PCM Officer carries out the PCM functions and administrative responsibilities according to the PCM rules of procedure. Information about the PCM and registered complaints can be found at www.ebrd.com/work-with-us/project-finance/project-complaint-mechanism.html.

The Bank's annual Anti-Corruption Report is published by OCCO. The report describes the Bank's strategy to promote integrity and prevent fraud and corruption, and highlights the most recent measures taken. It can be found at www.ebrd.com/integrity-and-compliance.html.

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 2017* as to the effectiveness of internal controls over external financial reporting, using the COSO (Committee of Sponsoring Organisations of the Treadway Commission) internal control framework (2013). This annual certification statement is signed by both the President and the Senior Vice President, Chief Financial Officer and Chief Operating Officer 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 and operational risks

Financial and operational risks are discussed in the Risk Management section of this report on page 27.

External auditor

The external auditor is appointed by the Board of Directors, on the recommendation of the President. In 2014 the Board approved an extension of the term of appointment from four to five years with a maximum of two consecutive terms. Deloitte LLP (UK) completed its first four-year term in 2014 and was re-appointed for the five-year period 2015-19.

The external auditor performs an annual audit in order to be able 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 (IFRS). 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 the service 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.

Reward policy

The Bank has designed a market-oriented staff reward policy, within the constraints of the Bank's status as an IFI, with the following principles that reward should:

- be competitively positioned in order to attract and retain high calibre employees from a wide range of member countries
- promote a culture where consistent high performance and behaviours that reflect the EBRD values and competencies are recognised and rewarded
- facilitate mobility in support of business objectives and continued staff development
- deliver a high quality package of benefits on a global basis which provides an appropriate level of security and is relevant to a diverse employee base
- engage with employees through an open and transparent Total Reward process.

To help meet these principles, the Bank's members 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

Staff on fixed-term or regular contracts receive a salary which is reviewed on 1 April each year. In addition, members of staff who are not eligible for overtime pay are eligible to receive a performance-based compensation award depending on the Bank's and the individual staff member's performance.

Staff on fixed-term or regular contracts, as well as most of the Board of Directors,[16] the President and Vice Presidents, are covered by medical insurance, life insurance and participate in the Bank's retirement plans. Certain staff hired from abroad may be eligible for some allowances to assist with costs related to their relocation.

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 (FSP) 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 the FSP). The rules for the retirement plans are approved by the Board of Directors and are

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

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.

President and Vice Presidents

The President is elected by the Board of Governors and typically receives a fixed-term contract of four years. The President's salary and benefits are approved by the Board of Governors. The President can participate in the same benefit schemes as the staff but s/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 salaries paid, from which internal tax is deducted, for each of these positions is as follows:

	2017 £ 000	2017 € 000	2016 £ 000	2016 € 000
President	354	404	351	430
First Vice President and Head of Client Services Group	325	371	322	394
Senior Vice President, Chief Financial Officer and Chief Operating Officer	311	355	296	362
Vice President, Risk and Compliance and Chief Risk Officer	296	339	294	360
Vice President, Banking[17]	297	339	n/a	n/a
Vice President and Chief Administrative Officer[18]	197	225	294	360
Vice President, Policy and Partnerships	297	339	294	360

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 for these positions, from which internal tax is deducted, are as follows:

	2017 £ 000	2017 € 000	2016 £ 000	2016 € 000
Director	150	171	148	181
Alternate Director	124	142	122	149

Senior management

Key management personnel comprise: members of the Bank's Executive Committee, Managing Directors and the Director of the President's Office. This group, excluding the President and Vice Presidents (for whom information is given above), consists of 36 individuals who received gross salaries, from which internal tax is deducted, in the ranges shown in the table below.[19] The average performance-based compensation award for eligible members of this group was 21 per cent of annual gross salaries in 2017 (2016: 22 per cent).

	2017 £ 000	2017 € 000	2016 £ 000	2016 € 000
Minimum	136	155	118	144
Median	186	212	184	225
Maximum	279	319	220	269
No. in group	36	36	36	36

[17] New Banking VP role 15 November 2016.

[18] Change of personnel 31 May 2017, new incumbent 2 October 2017.

[19] The General Counsel and the Secretary General are no longer eligible for performance-based compensation, hence their salaries were adjusted in 2017.

Income statement

These financial statements have been approved for issue by the Board of Directors on 27 February 2018.

For the year ended 31 December 2017	Note	Year to 31 December 2017 € million	Restated[20] Year to 31 December 2016 € million
Interest and similar income			
From Banking loans		974	966
From fixed-income debt securities and other interest		173	126
Interest expense and similar charges		(429)	(237)
Net interest income/(expense) on derivatives		36	(81)
Net interest income	3	754	774
Fee and commission income		80	80
Fee and commission expense		(6)	(3)
Net fee and commission income	4	74	77
Dividend income		185	97
Net gains from share investments at fair value through profit or loss	5	147	326
Net (losses)/gains from loans at fair value through profit or loss	6	(2)	9
Net gains from loans at amortised cost		7	15
Net gains from Treasury assets held at amortised cost	7	2	6
Net gains from Treasury activities at fair value through profit or loss and foreign exchange	8	47	84
Fair value movement on non-qualifying and ineffective hedges	9	(20)	131
Impairment provisions on Banking loan investments	10	(3)	(57)
Impairment provisions on guarantees		2	(3)
General administrative expenses	11	(395)	(445)
Depreciation and amortisation	19,20	(26)	(22)
Net profit for the year from continuing operations		772	992
Transfers of net income approved by the Board of Governors	25	(180)	(181)
Net profit after transfers of net income approved by the Board of Governors		592	811
Attributable to:			
Equity holders		592	811

Pages 18 to 80 are an integral part of these financial statements.

[20] As explained in note 32 on page 80.

Statement of comprehensive income

For the year ended 31 December 2017	Year to 31 December 2017 € million	Restated[21] Year to 31 December 2016 € million
Net profit after transfers of net income approved by the Board of Governors	592	811
Other comprehensive income/(expense)		
1. Items that will not be reclassified subsequently to profit or loss		
Share investments designated as fair value through other comprehensive income	1	12
Actuarial gains on defined benefit scheme	8	20
2. Items that may be reclassified subsequently to profit or loss		
Gains/(losses) on cash flow hedges	3	(2)
Total comprehensive income	604	841
Attributable to:		
Equity holders	604	841

Pages 18 to 80 are an integral part of these financial statements.

[21] As explained in note 32 on page 80.

Balance sheet

At 31 December 2017	Note	€ million	31 December 2017 € million	€ million	Restated[22] 31 December 2016 € million	€ million	Restated 31 December 2015 € million
Assets							
Placements with and advances to credit institutions	12	14,605		14,110		**11,724**	
Debt securities	13						
At fair value through profit or loss		916		926		**747**	
At amortised cost		9,465		8,981		**11,329**	
		10,381		9,907		**12,076**	
Collateralised placements		-		-		**13**	
			24,986		24,017		23,813
Other financial assets	14						
Derivative financial instruments		3,677		4,319		**4,596**	
Other financial assets		352		214		**335**	
			4,029		4,533		4,931
Loan investments							
Banking portfolio:							
Loans at amortised cost	15	22,630		23,012		**21,937**	
Less: Provisions for impairment	10	(850)		(1,044)		**(1,083)**	
Loans at fair value through profit or loss	16	372		313		**339**	
			22,152		22,281		21,193
Share investments							
Banking portfolio:							
At fair value through profit or loss	17	4,834		5,265		**5,033**	
Treasury portfolio:							
Share investments at fair value through other comprehensive income	18	76		75		**63**	
			4,910		5,340		5,096
Intangible assets	19		62		63		63
Property, technology and equipment	20		54		43		50
Total assets			56,193		56,277		55,146
Liabilities							
Borrowings							
Amounts owed to credit institutions and other third parties	21	2,650		2,478		**2,590**	
Debts evidenced by certificates	22	35,116		35,531		**34,280**	
			37,766		38,009		36,870
Other financial liabilities	23						
Derivative financial instruments		1,824		2,170		**2,993**	
Other financial liabilities		431		540		**577**	
			2,255		2,710		3,570
Total liabilities			40,021		40,719		40,440
Members' equity attributable to equity holders							
Paid-in capital	24	6,211		6,207		**6,202**	
Reserves and retained earnings	25	9,961		9,351		**8,504**	
Total members' equity			16,172		15,558		14,706
Total liabilities and members' equity			56,193		56,277		55,146
Memorandum items							
Undrawn commitments	26		12,770		12,075		12,959

Pages 18 to 80 are an integral part of these financial statements.

[22] As explained in note 32 on page 80.

Statement of changes in equity

For the year ended 31 December 2017	Subscribed capital € million	Callable capital € million	Revaluation reserve € million	Hedging reserve – cash flow hedges € million	Actuarial remeasurement € million	Retained earnings € million	Total equity € million
At 31 December 2015	29,674	(23,472)	7	-	(14)	8,391	14,586
Effect of change in accounting policy[23]	-	-	-	-	-	120	120
At 31 December 2015 as restated	29,674	(23,472)	7	-	(14)	8,511	14,706
Total comprehensive income for the year	-	-	12	(2)	20	811	841
Internal tax for the year	-	-	-	-	-	6	6
Capital subscriptions	29	(24)	-	-	-	-	5
At 31 December 2016	29,703	(23,496)	19	(2)	6	9,328	15,558
Total comprehensive income for the year	-	-	1	3	8	592	604
Internal tax for the year	-	-	-	-	-	6	6
Capital subscriptions	20	(16)	-	-	-	-	4
At 31 December 2017	29,723	(23,512)	20	1	14	9,926	16,172

Refer to note 25 “Reserves and retained earnings” on page 72 for a further explanation of the Bank’s reserves.

Pages 18 to 80 are an integral part of these financial statements.

[23] As explained in note 32 on page 80.

Statement of cash flows

For the year ended 31 December 2017	€ million	Year to 31 December 2017 € million	€ million	Restated[24] year to 31 December 2016 € million
Cash flows from operating activities				
Net profit for the year	592		811	
Adjustments to reconcile net profit to net cash flows:				
Non cash items in the income statement				
Depreciation and amortisation	26		21	
Gross provisions charge for Banking loan losses and guarantees	1		60	
Fair value movement on share investments	253		(326)	
Fair value movement on loans held at fair value through profit or loss	(3)		(24)	
Fair value movement on Treasury investments	(67)		207	
Other unrealised fair value movements	163		(10)	
Cash flows from the sale and purchase of operating assets				
Proceeds from repayments of Banking loans	7,552		9,124	
Funds advanced for Banking loans	(8,610)		(9,854)	
Proceeds from sale of Banking share investments	1,167		764	
Funds advanced for Banking share investments	(478)		(774)	
Net cash flows from Treasury derivative settlements	(54)		(32)	
Net placements to credit institutions	(4,353)		(1,500)	
Working capital adjustment:				
Movement in interest income	(46)		(68)	
Movement in interest expense	34		(126)	
Movement in net fee and commission income	5		96	
Movement in net income allocations payable	(220)		105	
Movement in accrued expenses	1		129	
Movement in dividend income receivable	(2)		2	
Net cash used in operating activities		(4,039)		(1,395)
Cash flows from investing activities				
Proceeds from sale of debt securities at amortised cost	12,153		12,724	
Purchases of debt securities at amortised cost	(13,108)		(10,341)	
Proceeds from sale of debt securities at fair value through profit or loss	4,192		901	
Purchases of debt securities at fair value through profit or loss	(4,181)		(1,065)	
Purchase of intangible assets, property, technology and equipment	(19)		(43)	
Cash flows (used in)/from investing activities		(963)		2,176
Cash flows from financing activities				
Capital received	4		5	
Issue of debts evidenced by certificates	22,367		15,526	
Redemption of debts evidenced by certificates	(19,615)		(15,328)	
Net cash from financing activities		2,756		203
Net (decrease)/increase in cash and cash equivalents		(2,246)		984
Cash and cash equivalents at beginning of the year		8,517		7,533
Cash and cash equivalents at 31 December[25]		6,271		8,517

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 31 December 2017 balance is €8 million restricted for technical assistance to be provided to member countries in the SEMED region (2016: €9 million).

Pages 18 to 80 are an integral part of these financial statements.

[24] As explained in note 32 on page 80.

[25] See note 12 on page 63 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" on page 21. The financial statements have been prepared on a going concern basis. The going concern assessment was made by the Bank's Board of Directors when approving the Bank's "Strategy Implementation Plan 2018-20" in December 2017, which analysed the Bank's liquidity position. The assessment was re-confirmed by the President and Senior Vice President, Chief Financial Officer and Chief Operating Officer on 27 February 2018, 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" on page 25.

New and amended IFRS mandatorily effective for the current reporting period

There are a number of amendments to standards effective for the current reporting period which have no or negligible impact on the Bank's financial statements, namely:

- Amendments to IAS 12: Income Taxes
- Amendments to IAS 7: Statement of Cash Flows

IFRS not yet mandatorily effective but adopted early

IFRS 9: "Financial Instruments" is the IASB's replacement project for IAS 39. The Standard has developed in phases and was completed in July 2014 with a mandatory application date for annual reporting periods beginning on or after 1 January 2018. The Bank adopted the first phase "recognition and measurement of financial assets" (November 2009) in its 2010 financial statements.

See the accounting policy for financial assets on page 20 for more details.

IFRS not yet mandatorily effective and not adopted early

The following standards are not yet effective and have not been adopted early.

Pronouncement	Nature of change	Potential impact
Amendments to: IFRS 2: Share-based Payment	Accounting for a modification of a share-based payment transaction that changes its classification from cash-settled to equity-settled. Effective for annual reporting periods beginning on or after 1 January 2018.	The Bank considers that this standard is not applicable to its operations.
Amendments to: IFRS 4: Insurance Contracts	Provides guidance for insurers in applying IFRS 9: Financial Instruments with IFRS 4: Insurance Contracts. Effective for annual reporting periods beginning on or after 1 January 2018.	The Bank considers that this standard is not applicable to its operations.
IFRS 9: Financial Instruments	Classification and measurement of financial liabilities (October 2010). Hedge accounting (November 2013). Impairment methodology and introduction of a "fair value through other comprehensive income" measurement category for financial assets represented by simple debt instruments (July 2014). IFRS 9 is to be adopted in its entirety for annual reporting periods beginning on or after 1 January 2018.	The Bank has commenced its implementation programme for these sections of IFRS 9. The Bank anticipates no material impact as a result of the implementation.
Amendments to: IFRS 10: Consolidated Financial Statements and IAS 28: Investments in Associates and Joint Ventures	Provides guidance for accounting for the loss of control of a subsidiary as a result of a transaction involving an associate or a joint venture that is accounted for using the equity method. Effective for annual reporting periods beginning on or after a date to be determined by the IASB.	The Bank anticipates no material impact as a result of adopting the changes to these standards.
IFRS 15: Revenue from Contracts with Customers	Establishes principles for reporting useful information to users of financial statements about the nature, amount, timing and uncertainty of revenue and cash flows arising from an entity's contracts with customers. Effective for annual reporting periods beginning on or after 1 January 2018.	The Bank anticipates no material impact as a result of adopting this standard.
IFRS 16: Leases	Sets out the principles for the recognition, measurement, presentation and disclosure of leases for both parties to a contract, that is, the customer (lessee) and the supplier (lessor). Effective for annual reporting periods beginning on or after 1 January 2019.	The Bank anticipates no material impact as a result of adopting this standard.
IFRS 17: Insurance Contracts	Establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. It also requires similar principles to be applied to reinsurance contracts held and investment contracts with discretionary participation features issued. Effective for annual reporting periods beginning on or after 1 January 2021.	The Bank has yet to assess the impact of this standard.

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 flows; 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.

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, requires 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 of accounting.

When an instrument that 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 the legal rights and obligations attaching to the instrument in accordance with IFRS.

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 to which a multiple is applied based on information from comparable companies 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 trade 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.

The Bank also accounts for a small number of strategic equity investments[26] at fair value through other comprehensive income with no recycling of such fair value gains or losses 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.

[26] See note 18 to the financial statements on page 66.

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 and therefore still applies IAS 39: Financial Instruments.

With the exception of derivative instruments that 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 of funding Treasury's trading assets which is recognised within "net gains from Treasury activities at fair value through profit or loss".

Contingent liabilities

Contingent liabilities are possible obligations arising from past events, whose existence will be confirmed only by uncertain future events, or present obligations arising from past events that are not recognised because either an outflow of economic benefits is not probable or the amount of the obligation cannot be reliably measured. Contingent liabilities are not recognised but information about them is disclosed unless the possibility of any outflow of economic benefits in settlement is remote.

Derivative financial instruments and hedge accounting

The Bank primarily makes use of derivatives for four 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;
(iii) to provide potential exit strategies for its unlisted equity investments through negotiated put options;
(iv) through currency swaps, to manage funding requirements for the Bank's loan portfolio.

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 values are positive and as liabilities when their fair values are negative. In 2016 the Bank introduced additional valuation measures for its over-the-counter (OTC)[27] derivatives portfolio to reflect credit and funding cost adjustments which the Bank reasonably anticipates will be incorporated into the exit price for such instruments. These adjustments, calculated at a portfolio level for each individual counterparty, allow for the following factors:

- the credit valuation adjustment (CVA) reflects the impact on the price of a derivative trade of changes in the credit risk associated with the counterparty;
- the debit valuation adjustment (DVA) reflects the impact on the price of a derivative trade of changes in the credit risk associated with EBRD, and
- the funding valuation adjustment (FVA) reflects the costs and benefits arising when uncollateralised derivative exposures are hedged with collateralised trades.

In line with market practice, in 2017 the Bank has added valuation adjustments to these derivatives attributable to "cheapest-to-deliver" factors, reflecting the value of terms and conditions relating to the posting of collateral in the Bank's Credit Support Annexes (CSA) agreements.

The valuation adjustment deriving from these factors is detailed within the Risk Management section of the report on page 38.

Hedge accounting

The Bank has not adopted early that part of IFRS 9 which relates to hedge accounting and therefore still applies IAS 39: Financial Instruments.

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.

[27] OTC derivatives are those not settled through a central clearing party.

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.

Cash flow hedges

The Bank has engaged in cash flow hedges to minimise the exchange rate risk associated with the fact that the majority of its administrative expenses are incurred in the pound sterling. The amount and timing of such hedges fluctuate in line with the Bank's view on opportune moments to execute the hedges. In October 2017 the Bank purchased in the forward foreign exchange market approximately seventy per cent of the pound sterling figure for the 2018 budget. The movement in the fair value of these hedges will be recognised directly in reserves until such time as the relevant expenditure is incurred, when the hedge gains or losses will be reflected as part of the euro-equivalent expenses for the year.

For further information on risk and related management policies see the Risk Management section of this report on page 27.

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 balance sheet 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

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

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. After initial impairment, subsequent 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 general provision). The methodology used for assessing such impairment is based on a risk-rated approach, with the methodology applied for all sovereign risk assets taking into account the Bank's preferred creditor status afforded by its members. The Bank's methodology calculates impairment on an incurred loss basis.[28] Impairment is deducted from the asset categories on the balance sheet.

The Bank additionally makes transfers within its reserves to maintain a separate loan loss reserve to supplement the cumulative amount provisioned through the Bank's income statement on an incurred loss basis.

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[28] See "Loss emergence period" on page 26 under "Critical accounting estimates and judgements".

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 and is divided into paid-in and callable shares. Paid-in shares are recognised on the balance sheet as members' equity. Callable shares will not be recorded on the balance sheet unless the Bank exercises its right to call the shares.

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 to seven years.

Property, technology and equipment

In 2017 the Bank took legal ownership of a stock of railcars in part settlement of a loan which was in default and which had been fully provisioned. The loan and associated provision were each reduced by the value attributed to the railcars. The railcars are classified as "property, technology and equipment" with income generated from the operation of the railcars classified as fee and commission income.

Property, technology and 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	Between five and ten years
Other (railcars)	20 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 its office accommodation, both in its UK headquarters and its resident offices in other countries in which it has a presence. 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 and expense is recognised on an accruals basis using the effective interest rate method. This method requires that, in addition to the contractual interest rate attaching to a financial instrument, those fees and direct costs associated with originating the instrument are also recognised as interest income or expense over the life of the instrument. The amortisation of such fees and costs is recognised in the same line of interest income or expense as the instruments to which they relate. Further details are provided below.

- Banking loans: this represents interest income on banking loans. Interest is recognised on impaired loans through unwinding the discount used in deriving the present value of expected future cash flows.
- Fixed-income debt securities and other: this represents interest income on Treasury investments with the exception of those measured at fair value where the interest is recognised in "net gains from Treasury activities at fair value through profit or loss". Where hedge accounting is applied to an underlying investment – typically using a swap to convert fixed-rate interest into floating – the net interest of the swap is included within this interest income line.
- Interest expense and similar charges: this represents interest expense on all borrowed funds. The majority of the Bank's borrowings are undertaken through the issuance of bonds that are usually paired with a one-to-one swap to convert the proceeds into the currency and floating rate profile sought by the Bank. Hedge accounting is applied to such relationships and the net interest of the associated swap is included within interest expense.
- Net interest income/(expense) on derivatives: in addition to swaps where the interest is associated with specific investments or borrowings, the Bank also employs a range of derivatives to manage the risk deriving from interest rate mismatches between the asset and liability side of the balance sheet. The net interest associated with these derivatives is presented separately as it is not identifiable to individual assets or liabilities presented elsewhere within "net interest income". This lack of specific "matching" also means that hedge accounting is not applied in respect of the risks hedged by these derivatives.

Fees received in respect of services provided over a period of time are recognised as income as the services are provided. In 2017, the Bank has changed its accounting policy for loan commitment fees so that they are now accounted for in this manner, rather than as a fee associated with origination of loans to be recognised in interest.[29] 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 when the Bank's right to receive payments has been established, and when it is probable that the economic benefits will flow to the Bank and the amount can be reliably measured.

Staff retirement schemes

The Bank has a defined contribution scheme and a defined benefit scheme to provide retirement benefits to its staff. 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.

Under the defined contribution scheme, the Bank and staff contribute to provide a lump sum benefit, such contributions being charged to the income statement and transferred to the scheme's independent custodians.

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. 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'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.

The defined benefit cost charged to the income statement represents the service cost and the net interest income/(cost) on the plan's net asset or liability. Remeasurements due to actuarial assumptions, including the difference between expected and actual net interest, are recognised in "other comprehensive income". The net defined benefit or liability recognised on the balance sheet is equal to the actual surplus or deficit of the defined benefit plan.

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.

[29] As explained in note 32 on page 80.

C. Critical accounting estimates and judgements

Preparing financial statements in conformity with IFRS requires the Bank to make estimates 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 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 countries in which the Bank invests, but which are not directly correlated to market risks such as interest rate and foreign exchange risk. The Bank's critical accounting estimates are outlined below.

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 are 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 on page 54.

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, a borrower's credit spreads, underlying equity prices and dividend cash flows. Where relevant market data are 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" in the Accounting Policies section of the report and an analysis of the share investment portfolio is provided in note 17 on page 65. 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" in the Risk Management section of the report on page 54.

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 (page 22) and further explained under credit risk within the Risk Management section of the report (page 29).

Portfolio provisions for the unidentified impairment of non-sovereign loan investments at 31 December 2017 were €230 million (2016: €250 million).

During 2017 the Bank carried out its regular annual review of the loss parameters underpinning estimates of unidentified impairment, with the aim of better reflecting the Bank's loss experience. This review resulted in a modest increase in the level of portfolio provisions. The key revisions to these estimates were:

Probability of default[30]

- In determining the probabilities of default (PD) for each risk rating, the historical data used to calibrate the rates were updated to include 2016 data. This was carried out for both the internal and external data used to determine the final probability of default rates.
- In addition, the relative weighting between internal and external default experience was changed to reflect an increased reliance on internal data, with the weighting now set at 75 per cent (previously 67 per cent).

If these changes to loss parameter estimates had been applied at 31 December 2016, the portfolio provisions for the unidentified impairment of non-sovereign loan investments would have increased by €5 million from €250 million to €255 million. The total increase, as a result of this change, in portfolio provisions (including sovereign loan investments) at 31 December 2016 would have been €8 million. No estimate of the effect these changes may have on future periods has been undertaken on the grounds of impracticability.

In addition, the sensitivity of portfolio provisions at 31 December 2017 to the key variables used in determining the level of impairment is provided below.

[30] See table showing probability of default ratings used by the Bank in the credit risk section under "Risk Management" on page 29.

Risk ratings

- If all non-sovereign loan investments were upgraded by three "notches" or detailed ratings on the Bank's probability of default rating scale, this would result in a reduction of €191 million (2016: €206 million) in portfolio provisions on non-sovereign loans.
- Conversely, if all non-sovereign loan investments were downgraded by three "notches" or detailed ratings on the Bank's probability of default rating scale this would result in a charge to the income statement of €409 million (2016: €403 million) in relation to portfolio provisions for non-sovereign loans.

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 2017 general provisioning methodology applies a 75 per cent weighting to the Bank's own experience and a 25 per cent weighting to external data. A +/- 10 percentage points change in the weighting assigned to the Bank's own experience would lead to a change in non-sovereign portfolio provisions of -/+ €28 million (2016: €25 million).

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 non-sovereign portfolio provisions charged to the income statement of approximately €170 million (2016: €186 million).

Loss given default rates

- A change in loss given default rates of 10 percentage points would lead to a change in non-sovereign portfolio provisions of +/- €51 million (2016: €56 million).

Sovereign ratings

- Portfolio provisions for the unidentified impairment of sovereign loan investments at 31 December 2017 amounted to €18 million (2016: €29 million). If all sovereign loans were downgraded by three "notches" or detailed ratings on the Bank's probability of default rating scale this would result in a total charge to income statement of €43 million (2016: €58 million). Similarly, if the portfolio was upgraded by three "notches" this would result in a release to the income statement of €15 million (2016: €24 million).

With respect to specific provisions, an increase or decrease of 10 percentage points on the current provision cover level would have an impact of +/- €85 million (2016: €121 million).

Judgements not involving estimation

In the process of applying its accounting policies, the Bank makes various judgements in addition to those involving estimation that can significantly affect the amounts recognised in the financial statements. These judgements are described in detail in the Accounting Policies section on page 18.

Risk management

Financial risks

Risk governance

The Bank's overall framework for identification and management of risks is underpinned by independent second line of defence[31] control functions, including the Risk Management department, Office of the Chief Compliance Officer, Environmental and Social Department, Finance Department, Evaluation Department and other relevant units. An Internal Audit Department acts as third line of defence and independently assesses the effectiveness of the processes within the first and second lines of defence. The Vice President, Risk and Compliance and Chief Risk Officer (CRO) is responsible for ensuring the independent risk management of the Banking and Treasury exposures, including adequate processes and governance structure for independent identification, measurement, monitoring and mitigation of risks incurred by the Bank. The challenge of the control functions, review of their status and assessment of their ability to perform duties independently falls within the remit of the Audit Committee of the Board.

Matters related to Bank-wide risk and associated policies and procedures are considered by the Risk Committee. The Risk Committee is accountable to the President. It oversees all aspects of the Banking and Treasury portfolios across all sectors and countries, and provides advice on risk management policies, measures and controls. It also approves proposals for new products submitted by Banking or Treasury. The membership comprises senior managers across the Bank including representatives from Risk Management, Finance, Banking and the Office of the General Counsel.

The Risk Committee is chaired by the VP Risk and Compliance, CRO.

The Managing Director, Risk Management reports to the VP Risk and Compliance, CRO and leads the overall management of the department. Risk Management provides an independent assessment of risks associated with individual investments undertaken by the Bank, and performs an ongoing review of the portfolio to monitor credit, market and liquidity risks and to identify appropriate risk management actions. It also assesses and proposes ways to manage risks arising from correlations and concentrations within the portfolio, and ensures that adequate systems and controls are put in place for identification and management of operational risks across the Bank. It develops and maintains the risk management policies to facilitate Banking and Treasury operations and promotes risk awareness across the Bank.

In exercising its responsibilities, Risk Management is guided by its mission to:

- provide assurance to stakeholders that risk decision-making in the Bank is balanced and within agreed appetite, and that control processes are rigorously designed and applied
- support the Bank's business strategy including the maximisation of transition impact through provision of efficient and effective delivery of risk management advice, challenge and decision-making.

Risks in 2018

Below is a summary of current top and emerging risks identified by the Bank. These are risks that, if they were to crystallise, have the potential to negatively affect the Bank's ability to carry out its mandate and/or which would cause a material deterioration in its portfolio. These risks therefore provide a background to understanding the changes in the Bank's risk profile and exposures and are closely monitored by management.

- Progressive economic fragmentation and further increase in prominence of parties and policies with "national (inward)" focus which may increase the challenge of delivering on transition and the Bank's mission overall.
- Substantial drop in emerging market equity prices and/or exchange rates, which could lead to material decrease in value and liquidity of the Bank's equity portfolio, resulting in financial losses and reduction in the Bank's capital base.
- Sharp capital outflows from several countries of operations (CoO), triggered for example by increasing US interest rates, which could lead to exchange rates shifts and increased costs of borrowing, posing new challenges for the Bank's clients and increasing credit risk of the Bank's investment portfolio.
- Escalation of instability and/or regional conflict in the Southern and Eastern Mediterranean Region (SEMED), with spillover effects on other countries in the region, leading to increased political risks and a deteriorating business environment.
- Material reform slowdown in one or more of the Bank's key markets (Turkey, Egypt, Poland, Ukraine and Kazakhstan), reducing the scope for the Bank's engagement in pursuing its mandate.

In carrying out its mission, the Bank is exposed to financial risks through both its Banking and Treasury activities. These are principally credit, market, operational and liquidity risks.

[31] With the Banking Vice-Presidency being the first line of defence in identifying and managing risks related to Banking debt and equity operations and the Treasury department being the first line of defence in identifying and managing risks related to Treasury exposure.

A. Credit risk

Credit risk is the potential loss to a portfolio that could result from either the default of a counterparty or the deterioration of its creditworthiness. The Bank also monitors concentration risk, which arises from too high a proportion of the exposure being exposed to a single obligor and/or exposure that has the potential to simultaneously deteriorate due to correlation to an event. Exposure to obligors in the same country or sector are examples but such concentrations could also include clusters or subsets of country or sector portfolios.

The Bank is exposed to credit risk in both its Banking and Treasury activities, as Banking and Treasury counterparties could default on their contractual obligations, or the value of the Bank's investments could become impaired. The Bank's maximum exposure to credit risk from financial instruments is approximated on the balance sheet, inclusive of the undrawn commitments related to loans and guarantees (see note 26 on page 74).

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

Individual projects

The Board of Directors approves a document that defines the principles underlying the credit process for the approval, management and review of Banking exposures. The Audit Committee periodically reviews these principles and its review is submitted to the Board for approval.

The Operations Committee reviews all Banking projects (both debt and equity transactions) prior to their submission for Board approval. The Committee is chaired by the First Vice President and Head of Client Services Group and its membership comprises senior managers of the Bank, including the VP Risk and Compliance, CRO and the Managing Director, Risk Management. A number of frameworks for smaller projects are considered by the Small Business Investment Committee or by senior management under a delegated authority framework supervised by the Operations Committee. The project approval process is designed to ensure compliance with the Bank's criteria for sound banking, transition impact and additionality. It operates within the authority delegated by the Board, via the President, to approve projects within Board-approved framework operations. The Operations Committee is also responsible for approving significant changes to existing operations.

The Equity Committee acts as the governance committee for the equity portfolio and reports to the Operations Committee. Risk Management is represented at both the Equity Committee and the Small Business Investment Committee.

Risk Management conducts reviews of all exposures within the Banking portfolio. 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. It also reviews the fair value of equity investments.

Portfolio level review

Risk Management reports on the development of the portfolio as a whole on a quarterly basis to senior management and the Audit Committee of the Board. The report includes a summary of key factors affecting the portfolio and provides analysis and commentary on trends within the portfolio and various sub-portfolios. It also includes reporting on compliance with all portfolio risk limits including an explanation of any limit breaches.

To identify emerging risk and enable appropriate risk mitigating actions Risk Management also conducts regular Bank-wide (top-down) and regional (bottom-up) stress testing exercises and comprehensive reviews of its investment portfolios. The Bank recognises that any resulting risk mitigation is constrained by the limited geographical space within which the Bank operates.

EBRD internal ratings

Probability of default (PD)

The Bank assigns its internal risk ratings to all counterparties, including borrowers, investee companies, guarantors, put counterparties and sovereigns in the Banking and Treasury portfolios. Risk ratings reflect the financial strength of the counterparty as well as consideration of any implicit support, for example from a major shareholder. The sovereign rating takes into consideration the ratings assigned by external rating agencies. For sovereign risk projects, the overall rating is the same as the sovereign rating. For non-sovereign operations, probability of default ratings are normally capped by the sovereign rating, except where the Bank has recourse to a guarantor from outside the country which may have a better rating than the local sovereign rating.

The table below shows the Bank's internal probability of default rating scale from 1.0 (lowest risk) to 8.0 (highest risk) and how this 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 risk rating category	EBRD risk rating	External rating equivalent	Category name	Broader category
1	1.0	AAA	Excellent	Investment grade
2	1.7 2.0 2.3/2.5	AA+ AA AA-	Very strong	Investment grade
3	2.7 3.0 3.3	A+ A A-	Strong	Investment grade
4	3.7 4.0 4.3	BBB+ BBB BBB-	Good	Investment grade
5	4.7 5.0 5.3	BB+ BB BB-	Fair	Risk range 5
6	5.7 6.0 6.3	B+ B B-	Weak	Risk range 6
7	6.7 7.0 7.3	CCC+ CCC CCC-/CC/C	Special attention	Risk range 7
8	8.0	D	Non-performing	NPL/Impaired assets

Loss given default (LGD)

The Bank assigns loss given default percentages on a scale of 3 to 100 determined by the seniority of the instrument in which the Bank invested.

Non-performing loans (NPL)

NPL definition

An asset is designated as non-performing when either the borrower is more than 90 days past due on payment to any material creditor, or when Risk Management considers that the counterparty is unlikely to pay its credit obligations in full without recourse by the Bank to actions such as realising security, if held.

Provisioning methodology

A specific provision is raised on all NPL accounted for at amortised cost. The provision represents the amount of anticipated loss, being the difference between the outstanding amount from the client and the expected recovery amount. The expected recovery amount is equal to the present value of the estimated future cash flows discounted at the loan's original effective interest rate.

General portfolio provisions

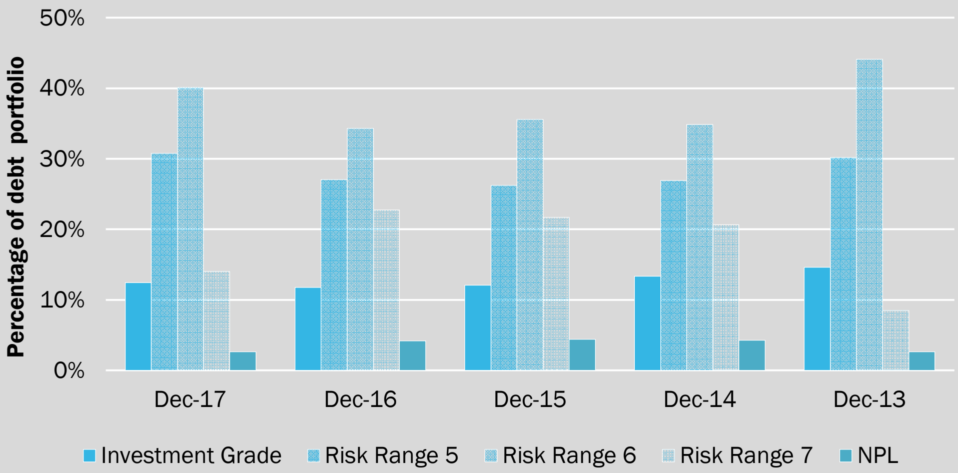
In the performing portfolio, provisions are held against losses incurred but not identified at the balance sheet date. These amounts are based on the PD rates associated with the rating assigned to each counterparty, the LGD parameters reflecting product seniority and the Exposure at Default (EAD). EAD is calculated based on outstanding operating assets and the expected disbursement of committed but not yet drawn amounts.

Credit risk in the Banking portfolio: 2017

Total Banking loan exposure (operating assets including fair value adjustments but before provisions) fell during the year from €23.2 billion at 31 December 2016 to €23.0 billion at 31 December 2017. The total signed Banking loan portfolio and guarantees increased from €33.8 billion at 31 December 2016 to €34.5 billion at 31 December 2017.

The average credit profile of the portfolio improved in 2017 as the weighted average probability of default (WAPD) rating decreased to 5.67 (2016: 5.80). Rating Range 7 Debt Assets (those risk rated 6.7 to 7.3) decreased from 22.7 to 14.0 per cent and the absolute level now stands at €4.9 billion (2016: €7.8 billion). This performance largely reflected relative stabilisation in the economic and political environment in the Bank's countries of operations which was reflected in particular by a number of sovereign upgrades in large relatively poorly rated countries such as Ukraine and Egypt. In spite of these positive developments however, external risks remain elevated.

Credit risk in the Banking portfolio 2017



NPL[32] declined over 2017, remaining low relative to the average portfolio risk rating, amounting to €0.9 billion or 3.9 per cent of operating assets at year-end 2017 (2016: €1.3 billion or 5.5 per cent). Distressed restructured loans[33] were also relatively low, comprising an additional €727 million or 3.1 per cent of operating assets at year-end 2017 (2016: €626 million or 2.7 per cent). Net write-offs amounted to €135 million in 2017 (2016: €79 million).

Specific provisions also improved in 2017, reflecting the stabilisation in the macro-financial environment in the countries in which the Bank invests, particularly in Ukraine and Egypt.

Movement in NPL[34]	2017 € million	2016 € million
Opening balance	1,292	1,316
Repayments	(315)	(228)
Write-offs	(135)	(79)
New impaired assets	119	269
Other movements	(63)	14
Closing balance	898	1,292

32 NPL include impaired loans at amortised cost of €0.8 billion (2016: €1.2 billion) and loans at fair value through profit or loss with an original cost of €49 million (2016: €75 million).

33 Defined as a loan in which any of the key terms and conditions have been amended due to the financial stress of the borrower, and without such amendment(s) would be likely to have become an impaired loan.

34 Includes loans at fair value that have no associated specific provisions.

Movement in specific provisions[35]	2017 € million	2016 € million
Opening balance	765	799
Provision cover	63%	64%
New/increased specific provisions	122	189
Provisions release – repayments	(90)	(117)
Provisions release – now performing	(19)	(11)
Provisions release – write-offs	(115)	(79)
Foreign exchange movement	(46)	13
Unwinding discount[36]	(15)	(29)
Closing balance	602	765
Provision cover[37]	71%	63%

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 category	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: Very strong	3	-	-	3	-	-	-	3	-
3: Strong	338	-	-	338	1.5	-	-	338	-
4: Good	2,571	-	-	2,571	11.4	(2)	-	2,569	0.1
5: Fair	7,404	99	-	7,503	33.2	(9)	-	7,494	0.1
6: Weak	8,402	3	-	8,405	37.1	(87)	-	8,318	1.0
7: Special attention	2,933	29	-	2,962	13.1	(150)	-	2,812	5.1
8: Non-performing[38]	-	-	848	848	3.7	-	(602)	246	71.0
At 31 December 2017	21,651	131	848	22,630	100.0	(248)	(602)	21,780	

Risk rating category	Restated[39] Neither past due nor impaired € million	Past due but not impaired € million	Impaired € million	Restated Total € million	Restated Total %	Portfolio provisions for unidentified impairment € million	Specific provisions for identified impairment € million	Restated Total net of impairment € million	Restated Impairment provisions %
2: Very strong	4	-	-	4	-	-	-	4	-
3: Strong	294	-	-	294	1.3	-	-	296	-
4: Good	2,380	-	-	2,380	10.3	(1)	-	2,378	-
5: Fair	7,039	-	-	7,039	30.6	(10)	-	7,028	0.1
6: Weak	7,605	-	-	7,605	33.1	(69)	-	7,536	0.9
7: Special attention	4,471	3	-	4,474	19.4	(199)	-	4,275	4.4
8: Non-performing	-	-	1,216	1,216	5.3	-	(765)	451	62.9
At 31 December 2016	21,793	3	1,216	23,012	100.0	(279)	(765)	21,968	

[35] Does not include fair value adjustments on impaired assets carried at fair value.

[36] Reduction in specific provisions due to interest income recognised.

[37] The ratio is calculated by dividing specific provisions over total impaired loans at amortised cost.

[38] The ratio of amortised cost impaired loans disclosed here is based on the exposure represented on the balance sheet rather than operating assets. Total NPL including fair value loans were 3.9 per cent of operating assets (2016: 5.5 per cent).

[39] As explained in note 32 on page 80.

At the end of 2017, €131 million of loans were past due but not impaired. Loans amounting to €120 million were past due for 30 days or less, and €11 million were past due for more than 30 days but less than 90 days (2016: €3 million past due, all of which were past due for more than 30 days but less than 90 days).

At 31 December 2017 the Bank had security arrangements in place for €7.2 billion of its loan operating assets (2016: €7.5 billion). Although this security is generally illiquid and its value is closely linked to the performance of the relevant loan operating assets, it does provide the Bank with rights and negotiating leverage that help mitigate overall credit risk. The Bank also benefited from guarantees and risk-sharing facilities extended by Special Funds and Cooperation Funds (see note 29 on page 77: Related Parties) which provided credit enhancement of approximately €90 million at the year-end (2016: €63 million).

Loans at fair value through profit or loss

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

Risk rating category	Fair value 2017 € million	Fair value 2016 € million
5: Fair	72	14
6: Weak	189	222
7: Special attention	106	71
8: Non-performing	5	6
At 31 December	372	313

Undrawn loan commitments and guarantees

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

Risk rating category	Undrawn loan commitments 2017 € million	Guarantees 2017 € million	Undrawn loan commitments 2016 € million	Guarantees 2016 € million
3. Strong	104	-	28	-
4: Good	1,265	8	1,275	-
5. Fair	3,008	90	2,123	20
6: Weak	4,897	339	3,642	195
7: Special attention	1,410	338	2,850	322
8: Non-performing	8	20	111	28
At 31 December	10,692	795	10,029	565

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

Credit risk in the Banking portfolio: Concentration

Concentration by country

The following table breaks down the main Banking credit risk exposures in their carrying amounts by country. The Bank is generally well diversified by country apart from its concentration in Turkey and Ukraine which account for 22.0 and 8.4 per cent of loans drawn down respectively (as shown below) and 17.8 and 10.6 per cent of the Bank's total loans including undrawn respectively. However, by the nature of the regional focus of the Bank's business model, some groups of countries in which the Bank operates are highly correlated.

	Loans 2017 € million	Undrawn loan commitments and guarantees 2017 € million	Total 2017 € million	Restated[40] Loans 2016 € million	Undrawn loan commitments and guarantees 2016 € million	Restated Total 2016 € million
Albania	134	278	412	154	340	494
Armenia	154	54	208	155	74	229
Azerbaijan	671	478	1,149	551	378	929
Belarus	346	108	454	359	105	464
Bosnia and Herzegovina	542	474	1,016	587	403	990
Bulgaria	772	123	895	822	152	974
Croatia	727	164	891	887	145	1,032
Cyprus	14	50	64	10	64	74
Czech Republic	3	-	3	4	-	4
Egypt	845	1,611	2,456	718	1,069	1,787
Estonia	65	-	65	70	-	70
Former Yugoslav Republic of Macedonia	236	455	691	243	474	717
Georgia	619	79	698	556	127	683
Greece	697	182	879	358	148	506
Hungary	341	39	380	257	47	304
Jordan	443	284	727	309	389	698
Kazakhstan	1,601	811	2,412	1,660	823	2,483
Kosovo	52	167	219	38	114	152
Kyrgyz Republic	135	116	251	175	72	247
Latvia	92	2	94	108	2	110
Lithuania	76	43	119	31	-	31
Moldova	125	442	567	141	340	481
Mongolia	699	80	779	901	42	943
Montenegro	227	120	347	209	138	347
Morocco	402	439	841	291	425	716
Poland	1,768	287	2,055	1,549	752	2,301
Romania	1,101	273	1,374	1,015	201	1,216
Russia	1,081	44	1,125	1,740	174	1,914
Serbia	1,252	750	2,002	1,274	737	2,011
Slovak Republic	220	142	362	151	160	311
Slovenia	168	41	209	186	19	205
Tajikistan	110	219	329	109	265	374
Tunisia	241	241	482	152	94	246
Turkey	5,070	1,072	6,142	5,123	755	5,878
Turkmenistan	39	11	50	25	12	37
Ukraine	1,925	1,744	3,669	2,399	1,554	3,953
Uzbekistan	9	64	73	8	-	8
At 31 December	23,002	11,487	34,489	23,325	10,594	33,919

[40] As explained in note 32 on page 80.

Concentration by industry sector

The following table breaks down the main Banking credit exposures in their carrying amounts by the industry sector of the project. The portfolio is generally well diversified with only depository credit (banks) constituting a material sector concentration.

	Loans 2017 € million	Undrawn loan commitments and guarantees 2017 € million	Total 2017 € million	Restated[41] Loans 2016 € million	Undrawn loan commitments and guarantees 2016 € million	Restated Total 2016 € million
Agribusiness	1,909	496	2,405	2,025	518	2,543
Depository credit (banks)	4,687	1,230	5,917	5,047	881	5,928
Information and communication technologies	611	6	617	605	91	696
Insurance, pension, mutual funds	101	1	102	57	-	57
Leasing finance	540	74	614	473	39	512
Manufacturing and services	2,226	412	2,638	2,488	341	2,829
Municipal and environmental infrastructure	1,651	1,105	2,756	1,451	1,102	2,553
Natural resources	1,902	499	2,401	2,261	748	3,009
Non-depository credit (non-bank)	172	50	222	240	31	271
Power and energy	2,910	1,067	3,977	2,703	990	3,693
Property and tourism	436	52	488	316	112	428
Transport	1,755	310	2,065	1,639	626	2,265
Non-sovereign	18,900	5,302	24,202	19,305	5,479	24,784
Sovereign	4,102	6,185	10,287	4,020	5,115	9,135
At 31 December	23,002	11,487	34,489	23,325	10,594	33,919

Concentration by counterparty

The Bank has a maximum nominal as well as risk-based non-sovereign Banking counterparty exposure limits. Maximum exposure (after risk transfers) to a non-sovereign economic group was €852 million at year-end 2017 (2016: €910 million).

Credit risk in Treasury: Management

Key risk parameters for funding, cash management, asset and liability management and liquidity risk appetite are approved by the Board of Directors and articulated in the Treasury Authority and Liquidity Policy (TALP). The TALP is the document by which the Board of Directors delegates authority to the Senior Vice President, Chief Financial Officer and Chief Operating Officer to manage and the Vice President Risk and Compliance, CRO to identify, measure, monitor and mitigate the Bank's Treasury exposures. The TALP covers all aspects of Treasury activities where financial risks arise and also Risk Management's identification, measurement, management and mitigation of those risks. In addition, Treasury Authority and Liquidity Procedures are approved by the Vice President Risk and Compliance, CRO to regulate operational aspects of Treasury risk-taking and the related risk management processes and procedures.

Eligible Treasury counterparties and investments are normally rated between 1.0 and 3.3 (approximately equivalent to S&P AAA to A– ratings), with the exception of counterparties approved for local currency activities in the countries where the Bank invests. These activities support the Bank's initiatives to provide local currency financing to Banking clients and to develop local capital markets. In cases where the creditworthiness of an issuer or counterparty deteriorates to levels below the standard of eligibility for new exposures, Risk Management and Treasury recommend actions for the approval of the Vice President Risk and Compliance, CRO and the Senior Vice President, Chief Financial Officer and Chief Operating Officer. Any decision to retain ineligible exposures is reported to the Audit Committee.

The Treasury Authority and Liquidity Procedures state the minimum rating and maximum tenor by type of eligible counterparty and set the maximum credit limits per rating. The internal credit rating scale is the same as that used for Banking exposure. The actual credit limit and/or tenor approved for individual counterparties by Risk Management may be smaller or shorter than the ceilings defined by Treasury Authority and Liquidity Procedures based on the likely direction of creditworthiness over the medium term, or on sector considerations. The limits apply across the range of eligible Treasury products for the relevant counterparty with exposures measured on a risk-adjusted basis. All individual counterparty and investment credit lines are monitored and reviewed by Risk Management at least annually.

[41] As explained in note 32 on page 80.

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. This includes all transaction types and is measured out to the maturity of the longest dated transaction with that counterparty. These potential future exposures (PFE) are calculated and controlled against approved credit limits on a daily basis with exceptions escalated to the relevant authority level for approval.

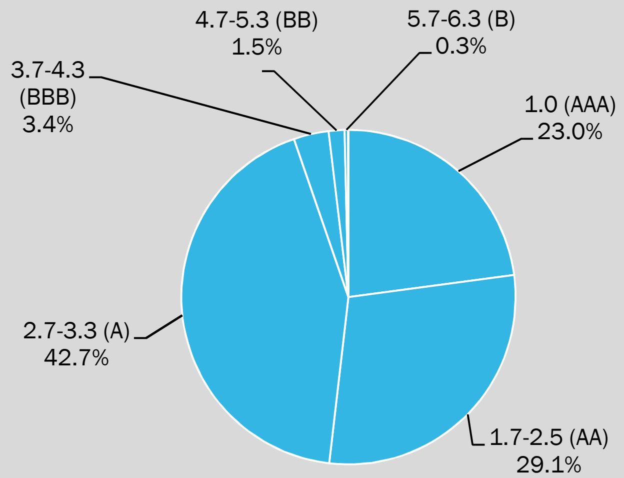
Risk mitigation techniques (such as netting and collateral) and risk transfer instruments reduce calculated credit exposure. For example, CSA for over-the-counter (OTC) derivatives activity reduce PFE in line with collateral posting expectations.

Credit risk in Treasury: Treasury liquid assets

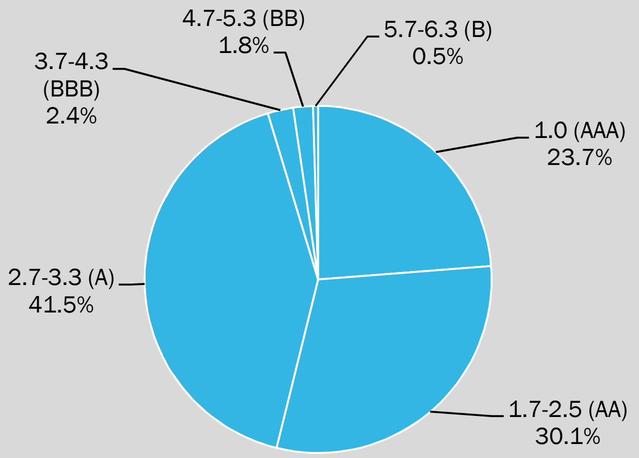
The carrying value of Treasury's liquid assets stood at €25.0 billion at 31 December 2017 (2016: €24.0 billion).[42]

The internal ratings of Treasury's counterparties and sovereign exposures are reviewed at least annually and adjusted as appropriate. Overall the WAPD rating, weighted by the carrying value of Treasury's liquid assets, improved to 2.32 at 31 December 2017 (2016: 2.34)

Credit quality of Treasury's liquid assets
31 December 2017



Credit quality of Treasury's liquid assets
31 December 2016



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 category	2017 € million	2016 € million
1: Excellent	287	568
2: Very strong	3,003	2,238
3: Strong	10,256	10,384
4: Good	649	442
5: Fair	372	436
6: Weak	32	42
7: Special attention	6	-
At 31 December	14,605	14,110

At 31 December 2017 there were no placements with and advances to credit institutions that were past due or impaired (2016: €nil).

[42] Treasury liquid assets consist of placements with and advances to credit institutions and debt securities.

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.

Risk rating category	2017 € million	2016 € million
1: Excellent	397	223
2: Very strong	112	502
3: Strong	141	-
4: Good	198	127
5: Fair	15	3
6: Weak	53	71
At 31 December	916	926

There were no debt securities at fair value past due in 2017 (2016: €nil).

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 category	2017 € million	2016 € million
1: Excellent	5,054	4,918
2: Very strong	2,914	2,790
3: Strong	1,497	1,273
At 31 December	9,465	8,981

There were no debt securities at amortised cost past due in 2017 (2016: €nil).

Treasury potential future exposure

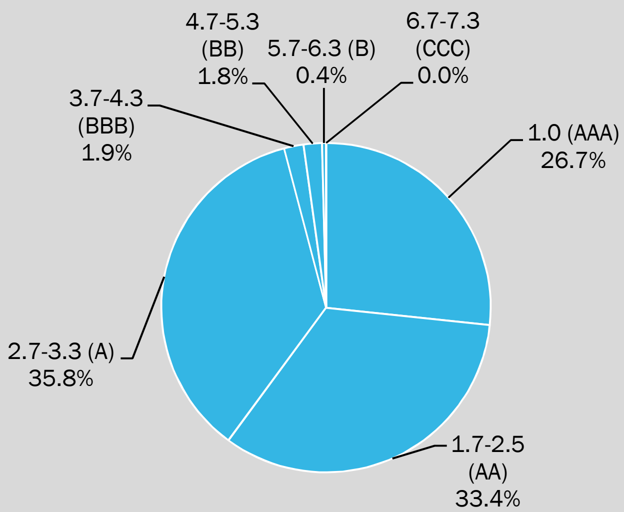
In addition to Treasury's liquid assets there are other products such as OTC swaps and forward contracts that are included within Treasury's overall PFE. PFE calculations show the future exposure throughout the life of a transaction or, in the case of collateralised portfolios, over the appropriate unwind periods. This is particularly important for Treasury's repo/reverse repo activity and hedging products such as OTC swaps and forwards. Calculation of PFE takes into account reduction in counterparty exposures through standard risk mitigations such as netting and collateral, which enables Risk Management to see a comprehensive exposure profile of all Treasury products (including liquid assets) against a specific counterparty limit on a daily basis.

Treasury PFE stood at €22.3 billion at 31 December 2017 (2016: €20.7 billion).

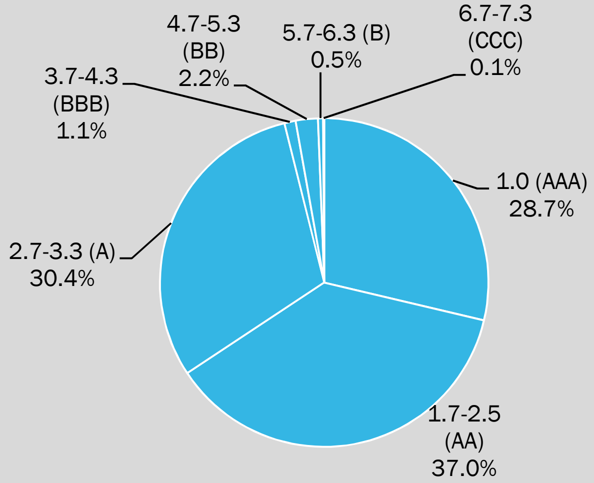
Treasury maintained a high-quality average credit risk profile during 2017 by investing liquidity in AAA sovereign and other highly rated assets. However the WAPD rating, weighted by PFE exposures, deteriorated slightly to 2.23 at 31 December 2017 (2016: 2.19).

A very low proportion of Treasury exposures was below investment grade quality,[43] amounting to around 2.3 per cent at 31 December 2017 (2016: 2.8 per cent). This comprised a small pool of local currency liquidity assets held with counterparties from the countries in which the Bank invests together with several financial sector bonds.

Credit quality of Treasury PFE
31 December 2017



Credit quality of Treasury PFE
31 December 2016



There were no impaired assets in the Treasury portfolio at 31 December 2017 (2016: €nil).

Derivatives

The Bank makes use of derivatives for different purposes within both its Banking portfolio and its Treasury activities. Within the Banking portfolio option contracts are privately negotiated with third parties to provide potential exit routes for the Bank on many of its unlisted share investments. Banking also has a limited portfolio of swaps with clients to hedge their market risks or to facilitate hard currency funding. Furthermore, Banking has a small number of currency swaps that are fully hedged and have been entered into with clients to assist them in the management of their market risks. Within Treasury, 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 (within the tight market risk limits described on page 45), while the transactions through which the Bank funds itself in capital markets are typically swapped into floating-rate debt with derivatives.

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.

[43] BB+/Ba1/BB+ level or worse.

The table below shows the fair value of the Bank's derivative financial assets and liabilities at 31 December 2017 and 31 December 2016.

	Assets 2017 € million	Liabilities 2017 € million	Total 2017 € million	Assets 2016 € million	Liabilities 2016 € million	Total 2016 € million
Portfolio derivatives not designated as hedges						
OTC foreign currency products						
Currency swaps	181	(91)	90	400	(82)	318
Spot and forward currency transactions	70	(148)	(78)	333	(151)	182
	251	(239)	12	733	(233)	500
OTC interest rate products						
Interest rate swaps	79	(152)	(73)	87	(170)	(83)
Caps/floors	-	-	-	1	-	1
OTC credit products						
Credit default swaps	-	(1)	(1)	-	-	-
Banking derivatives						
Fair value of equity derivatives held in relation to the Banking portfolio	455	(77)	378	567	(50)	517
Total portfolio derivatives not designated as hedges and Banking derivatives	785	(469)	316	1,388	(453)	935
Derivatives held for hedging						
Derivatives designated as fair value hedges						
Interest rate swaps	1,092	(259)	833	1,195	(237)	958
Cross currency interest rate swaps	1,361	(980)	381	1,672	(1,357)	315
Embedded derivatives[44]	438	(116)	322	64	(121)	(57)
	2,891	(1,355)	1,536	2,931	(1,715)	1,216
Derivatives designated as cash flow hedges						
Forward currency transactions	1	-	1	-	(2)	(2)
Total derivatives held for hedging	2,892	(1,355)	1,537	2,931	(1,717)	1,214
Total derivatives at 31 December	3,677	(1,824)	1,853	4,319	(2,170)	2,149

Set out below is an analysis of the Bank's derivative financial assets for each of the Bank's internal risk rating categories.

Risk rating category	2017 € million	2016 € million
1: Excellent	438	64
2: Very strong	1,234	760
3: Strong	1,489	2,800
4: Good	150	317
5: Fair	301	198
6: Weak	15	48
7: Special attention	50	132
At 31 December	3,677	4,319

There were no derivative financial assets past due in 2017 (2016: €nil).

[44] Where a financial liability held at amortised cost contains an embedded derivative which is of a different economic character to the host instrument, and the liability does not qualify for hedge accounting, that embedded derivative is bifurcated and measured at fair value through the income statement. All such derivatives bifurcated by the Bank are embedded in Debts Evidenced by Certificates.

Included in the valuation of derivatives is an overall positive value to the Bank of €43 million attributable to the counterparty portfolio-level adjustments for CVA/DVA/FVA (2016: €44 million). The Bank implemented valuation adjustments for CVA/DVA/FVA in 2016 in line with the latest market practice for fair valuing derivatives. The valuation adjustment may be analysed thus:

- CVA: the credit valuation adjustment which reflects the impact on the price of a derivative trade from changes in the credit risk associated with the counterparty; €11 million (2016: €14 million)
- DVA: the debit valuation adjustment which reflects the impact on the price of a derivative trade from changes in the credit risk associated with the EBRD; €(6) million (2016: €(11) million)
- FVA: the funding valuation adjustment which reflects the costs and benefits arising when uncollateralised derivative exposures are hedged with collateralised trades; €38 million (2016: €41 million)

Also included in the valuation of derivatives is an overall negative value to the Bank of €18 million attributable to "cheapest-to-deliver" (CTD) adjustments reflecting the value of terms and conditions relating to the posting of collateral in the Bank's CSA agreements. The Bank implemented valuation adjustments for CTD in 2017 in line with the latest market practice for fair valuing derivatives. There was therefore no comparable valuation adjustment made in 2016.

In order to manage credit risk in OTC derivative transactions,[45] the Bank's policy is to approve, in advance, each counterparty individually and to review its creditworthiness and eligibility regularly. Derivatives limits are included in overall counterparty credit limits. OTC derivative transactions are normally carried out only with the most creditworthy counterparties, rated at the internal equivalent of 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 derivative transactions are documented under a Master Agreement (MA) and a 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 usually a function of the counterparty's 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. Similarly, the Bank emphasises risk mitigation for repurchase and reverse repurchase agreements and related transaction types through MA documentation.

Collateral

The Bank mitigates counterparty 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 2017 this exposure stood at €1.4 billion (2016: €2.0 billion). Against this, the Bank held collateral of €1.4 billion (2016: €2.0 billion), reducing its net credit exposure to €nil (2016: €nil).

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 2017 € million	Sold or repledged 2017 € million	Held collateral 2016 € million	Sold or repledged 2016 € million
Derivative financial instruments				
High grade government securities	60	-	640	-
Cash	1,358	1,358	1,336	1,336
	1,418	1,358	1,976	1,336
Reverse sale and repurchase transactions	3,828	34	4,912	-
At 31 December	5,246	1,392	6,888	1,336

Where the Bank sells securities subject to a commitment to repurchase them (a repurchase agreement) but does not transfer the risk and rewards of ownership, the transactions are treated as collateralised borrowings. The securities remain included in the balance sheet and are deemed to be held by the counterparty as collateral. The table below shows the carrying amount of collateral that has been pledged by the Bank in connection with its borrowings.

Collateral pledged as security	Pledged collateral 2017 € million	Pledged collateral 2016 € million
Sale and repurchase transactions	393	356

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

The table below shows the reported values of derivatives that are subject to MA netting arrangements.

	Recognised derivative assets 2017 € million	Recognised derivative liabilities 2017 € million	Net position 2017 € million	Collateral held 2017 € million
Subject to a master netting agreement				
Net derivative assets by counterparty	1,997	(593)	1,404	1,392
Net derivative liabilities by counterparty	751	(1,028)	(277)	26
	2,748	(1,621)	1,127	1,418
No master netting agreement				
Other derivatives	36	(10)	26	-
Embedded derivatives	438	(116)	322	-
Equity derivatives	455	(77)	378	-
	929	(203)	726	-
At 31 December	3,677	(1,824)	1,853	1,418

	Recognised derivative assets 2016 € million	Recognised derivative liabilities 2016 € million	Net position 2016 € million	Collateral held 2016 € million
Subject to a master netting agreement				
Net derivative assets by counterparty	2,764	(809)	1,955	1,952
Net derivative liabilities by counterparty	904	(1,187)	(283)	24
	3,668	(1,996)	1,672	1,976
No master netting agreement				
Other derivatives	20	(3)	17	-
Embedded derivatives	64	(121)	(57)	-
Equity derivatives	567	(50)	517	-
	651	(174)	477	-
At 31 December	4,319	(2,170)	2,149	1,976

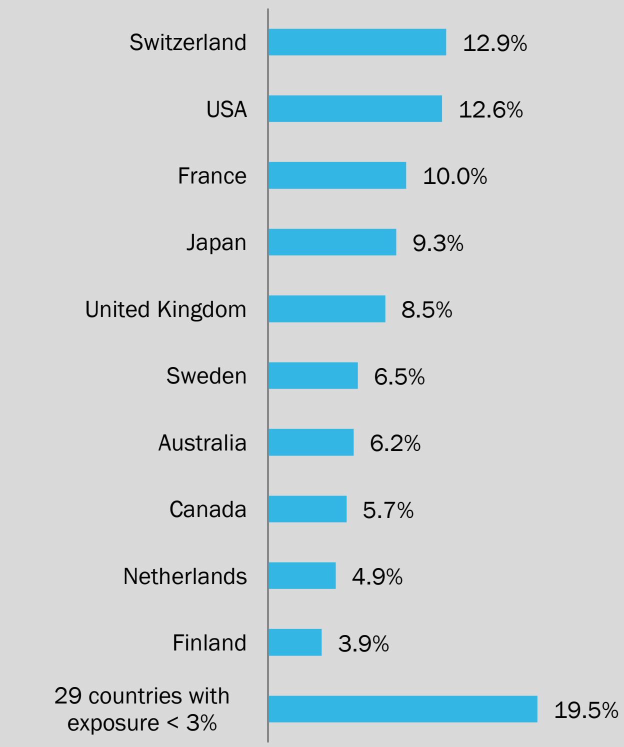
Credit risk in Treasury: Concentration

Concentration by country

At the end of 2017, Treasury credit risk exposure was spread across the following countries.

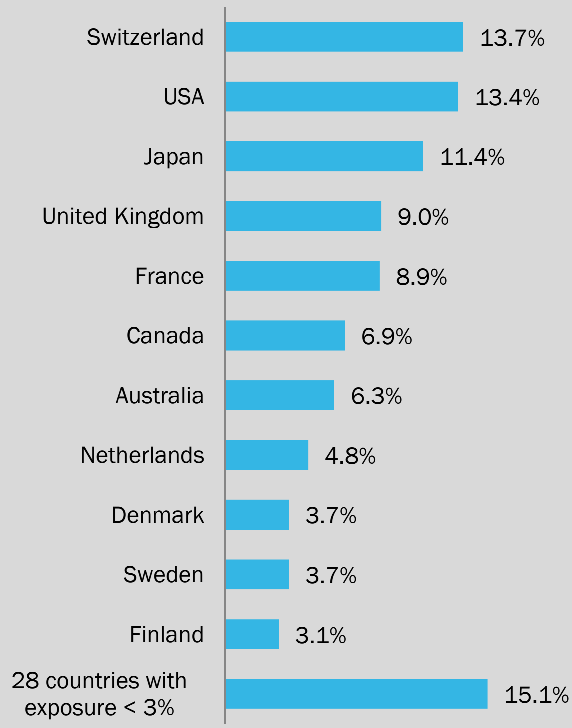
Concentration of Treasury peak exposure by country/region

31 December 2017



Concentration of Treasury peak exposure by country/region

31 December 2016

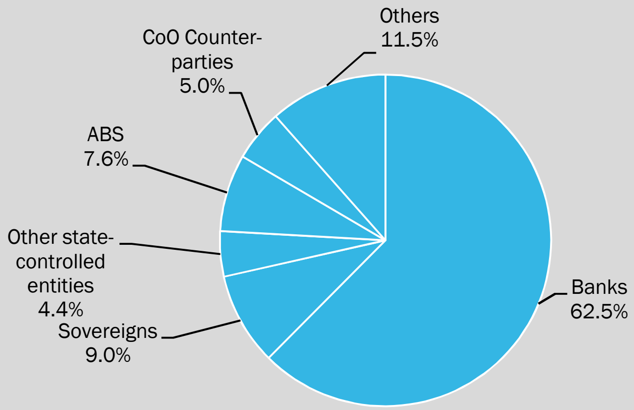


Concentration by counterparty type

The Bank continues to be largely exposed to banks in the Treasury portfolio which accounted for 63 per cent of the portfolio peak exposure (2016: 59 per cent). Direct sovereign exposure[46] decreased to 9 per cent (2016: 15 per cent), while exposure to counterparties in the countries in which the Bank invests remained at 5 per cent (2016: 5 per cent) on a PFE basis.

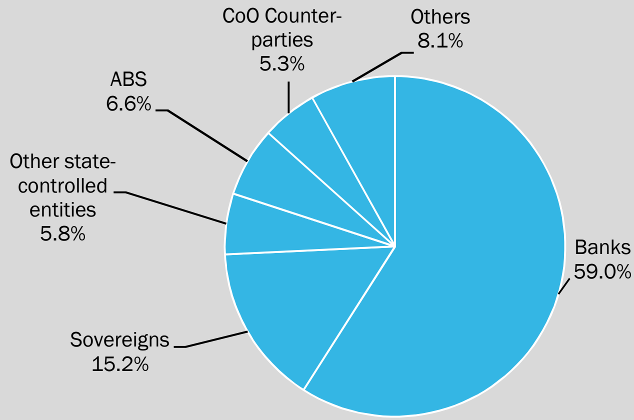
Concentration of peak exposure by counterparty type

31 December 2017



Concentration of peak exposure by counterparty type

31 December 2016



CoO: Countries of operations ABS: Asset-backed securities

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.

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 the euro the foreign exchange risk is hedged by Treasury. 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[47] 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.

The EBRD takes a long-term view of its equity investments, and therefore accepts the short-term volatilities in value arising from exchange rate risk and price risk.

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

[47] Value-at-risk (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 (eVaR) is the average loss beyond the VaR level and is a more accurate measure of large potential losses.

Foreign exchange risk

The Bank is subject to foreign exchange risks as it invests in equities that are denominated in currencies other than the euro. Accordingly, the value of the equity investments may be affected favourably or unfavourably by fluctuations in currency rates. The table below indicates the currencies to which the Bank had significant exposure on its equity investments at 31 December 2017.[48] The sensitivity analysis summarises the total effect of a reasonably possible movement of the currency rate[49] against the euro on equity fair value and on profit or loss with all other variables held constant.

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
Euro	-	1,815	-
Hungarian forint	2.0	126	3
Polish zloty	2.8	186	5
Romanian leu	1.0	299	3
Russian rouble	21.2	638	135
Turkish lira	16.1	288	46
Ukrainian hryvnia	28.0	133	37
United States dollar	8.6	853	74
Other non-euro	12.0	496	60
At 31 December 2017		4,834	363

	5-year rolling average movement in exchange rate %	Fair value € million	Impact on net profit € million
Euro	-	1,760	-
Hungarian forint	3.2	141	5
Polish zloty	3.3	375	12
Romanian leu	1.0	293	3
Russian rouble	20.5	871	178
Turkish lira	12.3	296	37
Ukrainian hryvnia	25.0	111	28
United States dollar	6.3	959	60
Other non-euro	10.6	459	49
At 31 December 2016		5,265	372

The average movement in exchange rate for the “other non-euro” consists of the weighted average movement in the exchange rates listed in the same table.

[48] The table reflects the currency in which shares are denominated. For most of the share investments denominated in euro (€1.76 billion) and in United States dollar (€959 million) the underlying risk exposures (and cash flows determining the equity values) are in local currency of one of the countries of operations. As a result, the overall foreign exchange risk for these exposures also includes movements between the relevant local currency and either euro or United States dollar (but which is outside the scope of this disclosure).

[49] Based on a five-year rolling average movement in the exchange rate.

Equity price risk

Equity price risk is the risk of unfavourable changes in the fair values of equities as the result of changes in the levels of equity indices and the value of individual shares. 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, for both listed and unlisted equity investments. The table below summarises the potential impact on the Bank's net profit from a reasonably possible change in equity indices.[50]

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
Georgia	BGAX Index	14.1	92	13
Greece	GREK Index	28.0	152	43
Poland	WIG Index	10.5	308	32
Romania	BET Index	9.4	332	31
Russia	INDEXCF Index	13.5	1,074	145
Serbia	BELEX15 Index	9.4	102	10
Turkey	XU100 Index	22.5	437	98
Ukraine	PFTS Index	20.8	166	35
Regional and other	Weighted average	15.3	2,171	331
At 31 December 2017			4,834	738

		5-year rolling average movement in benchmark index %	Fair value € million	Impact on net profit € million
Georgia	BGAX Index	13.5	112	15
Greece	GREK Index	27.4	170	47
Poland	WIG Index	11.1	543	60
Romania	BET Index	11.2	294	33
Russia	MICEX Index	13.4	1,570	211
Serbia	BELEX15 Index	9.2	191	18
Turkey	XU100 Index	23.5	404	95
Ukraine	PFTS Index	24.8	132	33
Regional and other	Weighted average	15.0	1,849	277
At 31 December 2016			5,265	789

The average movement in benchmark index for "regional and other" is made up of the weighted average movement in benchmark indices of the countries listed in the same table.

Commodity risk in the Banking portfolio

The Bank is exposed to commodity risk through some of its investments and due to the significant importance of commodities in a number of the countries in which it invests. The aggregate direct exposure to oil and gas extraction, metal ore mining and coal mining (and related support activities) amounts to 4.3 per cent (2016: 4.5 per cent) of the overall banking portfolio. Although the share of this portfolio is still a small percentage of the total, the potential overall risk can be more substantial, as several countries in which the Bank invests, most notably Azerbaijan, Kazakhstan, Mongolia and Russia, are heavily reliant on commodity exports to support their economic growth, domestic demand and budgetary revenues. A prolonged and material decline in oil prices would have an adverse effect on hydrocarbon producers and processors, as well as on the relevant sovereigns and corporate clients reliant on domestic demand. The Bank monitors this risk carefully and incorporates oil price movements into its stress testing exercises.

[50] Based on a five-year rolling average movement in the relevant equity market indices.

Market risk in the Treasury portfolio

Interest rate and foreign exchange risk

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. These risks are centralised and hedged by the Asset and Liability Management desk in Treasury.

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 interest is fixed on a financial instrument indicates the extent to which it is exposed to interest rate risk. Interest rate risks are managed by synthetically hedging the interest rate profiles of assets and liabilities through the use of exchange-traded and OTC derivatives.

The Bank measures its exposure to market risk and monitors limit compliance daily. The main market risk limits in the Bank are based on eVaR computed at a 95 per cent confidence level over a one-day trading horizon. eVaR is defined as the average potential loss above a certain threshold (for example 95 per cent) that could be incurred due to adverse fluctuations in interest rates and/or foreign exchange rates. The Bank's overall eVaR limit, laid down in the Board-approved TALP, at a 95 per cent confidence level over a one-day trading horizon is €60.0 million (less than 0.5 per cent of capital).

For enhanced comparability across institutions, numbers disclosed in this financial report show eVaR-based measures scaled up to a 10-trading-day horizon. The market risk methodology considers the three-month swap curve as the main interest rate risk factor and the other factors as basis spread risk factors.[51] The total eVaR (95 per cent confidence level over a 10-day trading horizon) of the Bank's Treasury portfolio, including basis spread risks, stood at €11.8 million at 31 December 2017 (2016: €11.1 million) with an average eVaR over the year of €14.8 million (2016: €17.2 million). Year on year, the total eVaR was marginally higher driven primarily by higher euro swap curve risk counterbalanced by lower government bond spread risk, to which Treasury is exposed through its sovereign bond holdings. Interest rate option exposure remained modest throughout the year with option eVaR at €0.5 million at year-end (2016: €0.6 million), having peaked at €2.2 million during the year (2016: €3.7 million). The specific contribution from foreign exchange risk to the overall eVaR stood at €1.5 million at year-end (2016: €1.5 million). As in previous years, this contribution was small throughout 2017 and never exceeded €4.3 million (2016: € 3.2 million).

Equity price risk

The Bank had direct exposure to equity risk of €76 million at 31 December 2017 through three Treasury share investments[52] (2016: €75 million). 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.

[51] Spread risk arises from cross-currency basis spreads, tenor spreads (for example, between 6-month and 3-month Libor), Overnight Index Swap (OIS) vs. 3-month Libor spread and government bond spreads.

[52] See note 18 to the financial statements on page 66.

C. 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 (financially and/or to our reputation) resulting from inadequate or failed internal processes, people and systems or from external events.

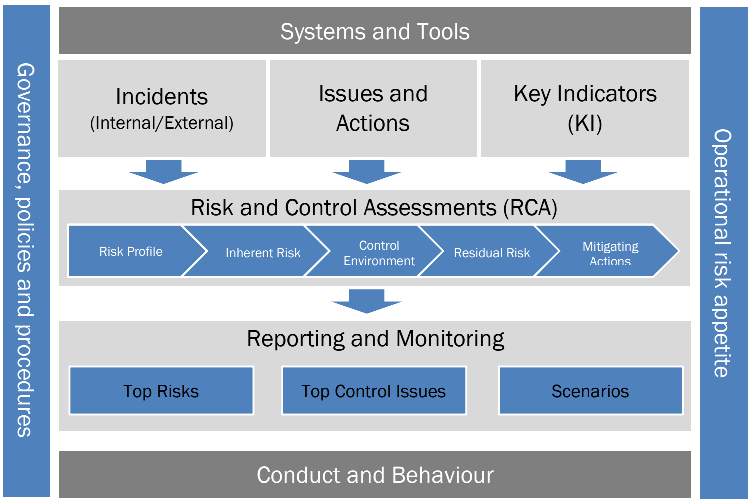
Sources of operational risk

Operational risk can manifest itself in various ways, including business interruptions, inappropriate behaviour of employees (including fraud), failure to comply with applicable laws and regulations or failure of vendors to perform in accordance with their contractual arrangements. These events could result in financial losses, as well as reputational damages to the Bank.

Operational Risk Framework

The Bank's Operational Risk Framework (ORF) is a network of processes, procedures, reports and responsibilities that are used to identify, manage and monitor the operational risks of the Bank. These include governance committees, day-to-day management practices such as the collection and analysis of key risks, risk of loss incidents and both strategic and cultural practices.

The ORF provides a structured approach to managing operational risk. It seeks to apply consistent standards and techniques for evaluating risks across the Bank within which individual businesses have sufficient flexibility to tailor specific components to their own needs.



The main components of the Operational Risk Framework are described below:

Governance, policies and procedures

The Bank utilises a comprehensive set of policies and procedures that set out how operational risks should be managed throughout the bank.

Operational risk appetite

This determines our approach to risk taking and articulates the motivations for taking, accepting or avoiding certain types of risks or exposures.

Incidents

The Bank systematically collects, analyses and reports data on operational risk incidents to ensure we understand the reasons they occurred and how controls can be improved to reduce the risk of future incidents. We also collect and utilise available data on incidents at relevant peer firms through the Global Operational Risk Loss Database to identify potential risks that may be relevant in the future, even if they have not currently impacted the Bank.

Issues and actions

Issues comprise a catalogue of problems the business faces with potential operational risks arising as a consequence of business activities. Actions address these issues and are steps taken to ensure these issues do not present operational risks.

Key indicators

These are metrics that are used to monitor particular operational risks and controls over time.

Risk and control assessments

RCAs are comprehensive, bottom-up assessments of the key operational risks in each business. They comprise a self-assessment that defines a risk profile based on Bank-wide operational risk taxonomy, classifies risks under a standardised approach, covers the inherent risks of each business and control function, provides an evaluation of the effectiveness of the controls in place to mitigate these risks, determines the residual risk ratings and requires a decision to either accept or remediate any residual risks.

Reporting and monitoring

The Bank produces a wide range of regular management information reports covering the key inputs and outputs of the ORF. These reports are used by senior management to monitor outcomes against agreed targets and tolerance levels.

Systems and tools

The Bank utilises system and tools to ensure operational risks are identified and managed properly.

Conduct and behaviour

Several ORF components include assessments of behaviour as effective operational risk management relies on employees conducting themselves appropriately. For example, investigations of incidents typically consider whether employees escalated issues at an appropriately early stage. Risks that have implications for conduct risk can be identified and assessed via the operational risk register and the RCA process.

Key risks and mitigations

The Bank continually assesses and strengthens its risk and control processes and technological support tools to increase their effectiveness.

The following table summarises key operational risks currently considered most relevant to our business.

Key Risk	Description	How is the risk managed
Reputational risk	Reputational risk can arise from any of the key risks outlined below. Reputational risk relates to the Bank's brand, as well as ethics, trust, relationships with clients and stakeholders, conduct and the overall culture and values of our organisation. Reputational risk may also arise from taking on inappropriate client relationships which may have adverse implications for the Bank.	Consider key reputational risks when initiating changes in strategy or operating model. Engage in proactive communications with all stakeholders and monitor media coverage to understand how our reputation is perceived. In addition, a number of controls and frameworks are in place to address other risks that could affect our reputation including: conduct risk, financial crime, investment risk and client take-on and product development.
Conduct risk	The potential detriment to the EBRD, its stakeholders and clients with respect to investment management, lending fraud, market integrity, money laundering, bribery and corruption.	Managed through a framework focusing on enhancements to risk identification, mitigation, management information, reporting in conjunction with line management, Compliance and Human Resources.
People risk	The risk that losing one important employee or team would cause a significant negative impact to the Bank or that failing to attract talent leads to sub-optimal performance. This relates to investment staff or teams associated with key products or other individuals with significant experience or specialist knowledge (for example, key operator or IT system specialists).	Key mitigations include identifying and developing resources to support front to back processes, talent management programme and succession planning. Develop comprehensive procedure documentation of all key processes and where possible include as part of disaster recovery tests.
Process risk	Risk arising from the failure of significant business processes undertaken by EBRD, including for example critical transaction and payments processing, client suitability checks and asset pricing.	Risk and Control Assessments are used to identify and assess key operational risks. Associated controls are assessed with regard to their design and performance. Where required, processes and controls are enhanced to improve the control environment with the aim of preventing risk events from recurring.

Change management risk/project risk	Risk of negative impact from change/projects/initiatives. Project risk is the risk that ineffective project implementation could lead to sub-optimal solutions being delivered on our key projects.	Dedicated change management team overseeing all major projects, ensuring that consistent, Bank-wide rigour is brought to the initiation, approval and monitoring of projects. The Bank does not implement new processes and systems before they have been fully tested.
Cyber crime	Risk of loss or detriment to the Bank's business and customers as a result of actions committed or facilitated through the use of networked information systems.	The Bank's IT and information security procedures and processes ensure that all servers and computers have up to date antivirus software. Backups are made regularly and we perform regular access control checks, system penetration and vulnerability tests along with disaster recovery tests. The Bank's anti-cyber attack controls are checked and aligned with external best practice.
Business continuity risk	Business continuity risk is the risk that, for a number of reasons, we are unable to continue to operate.	Continuity planning is in place across the business with clear identification of key staff and their involvement in business resumption plans. This includes annual disaster recovery testing at the Bank's back-up site. Bank-wide insurance held against a loss resulting from interruption to the business consequent upon loss or damage to our property. We work closely with our third party suppliers to maintain the quality and continuity of service.
Technology risk	The risks that our technology systems and support are inadequate or fail to adapt to changing requirements.	Build a technology risk management operating model that enables the organisation to identify, measure, and manage technology risks against its business objectives, critical processes, and information risks. Ensure consideration for key areas such as incident, change, and capacity management. Regularly review the progress of major information technology projects and new systems are subject to rigorous testing before approval.
Third-party service provider risk	Inadequate selection and ongoing management of external suppliers. Third-party service provider risk relates to the risk that suppliers may not be able to meet their agreed service level terms.	Before entering into third-party arrangements, we undertake due diligence on third-party suppliers and maintain a programme of regular assessment against agreed service levels. Exit plans are considered prior to appointment and provide a framework for transitioning business from one service provider to another should the quality fall below the agreed service level.

Outlook

In line with other financial institutions, information- and cyber security will remain a key focus for the Bank in 2018 when we expect to see further benefits of the current policies and programmes. The recently approved IT strategy contains additional investment focused on continued enhancements in our defence against cyber attacks to counteract the increased threats experienced across the industry. In addition, the Bank's change management programme will continue to ensure the management and mitigation of the potential business disruption risks. Overall the Operational Risk outlook within the Bank is assessed as stable.

D. Liquidity risk

Liquidity risk management process

The Bank's liquidity policies are reviewed annually and any changes approved by the Board of Directors. The policies are designed to ensure that the Bank maintains a prudent level of liquidity, given the risk environment in which it operates, and to support its AAA credit rating.

The Bank's medium-term liquidity requirements are based on satisfying each of the following three minimum constraints:

- net Treasury liquid assets must be at least 75 per cent of the next two years' projected net cash requirements, without recourse to accessing funding markets;
- the Bank's liquidity must be considered a strong positive factor when rating agency methodologies are applied. These methodologies include applying haircuts to the Bank's liquid assets, assessing the level of debt due within one year and considering undrawn commitments. This provides an external view of liquidity coverage under stressed circumstances;
- the Bank must be able to meet its obligations for at least 12 months under an extreme stress scenario. This internally generated scenario considers a combination of events that could detrimentally impact the Bank's liquidity position.

For the purposes of the net cash requirements coverage ratio above, all assets managed within the Treasury portfolio are considered to be liquid assets while "net" treasury liquid assets represent gross treasury assets net of short-term debt.[53]

The Bank holds liquidity above its minimum policy levels to allow flexibility in the execution of its borrowing programme. At 31 December 2017, the Bank's key medium term liquidity metrics were as follows:

- net Treasury liquid assets represented 148 per cent (2016: 118 per cent) of the next two years' net cash requirements against a minimum 75 per cent coverage;
- Treasury liquid assets (after the application of haircuts) represented 106 per cent (2016: 110 per cent) of one year debt service plus 50 per cent of undrawn commitments, against a minimum 100 per cent coverage.

The average weighted maturity of assets managed by Treasury at 31 December 2017 was 1.4 years (2016: 1.3 years).

The Bank's short-term liquidity policy is based on the principles of the Liquidity Coverage Ratio within the Basel III reform package. The policy requires that the ratio of maturing liquid assets and scheduled cash inflows to cash outflows over both a 30-day and 90-day horizon must be a minimum of 100 per cent. The minimum ratios under the Bank's policy have been exceeded at 31 December 2017 and consistently throughout the year.

In addition to the above, Treasury actively manages the Bank's liquidity position on a daily basis.

The Bank has a proven record of access to funding in the capital markets via its global medium-term note programme and commercial paper facilities. In 2017 the Bank raised €8.2 billion of medium to long-term debt with an average tenor of 3.8 years (2016: €5.6 billion and 3.8 years). The Bank's AAA credit rating with a stable outlook was affirmed by the three major rating agencies in 2017.

The Bank's liquidity policies are subject to independent review by Risk Management prior to their submission for Board approval.

[53] For this ratio, short-term debt is debt with a fixed or optional maturity of one year or less at the point of acquisition – that is, it is not debt where the remaining maturity was one year or less at 31 December 2017.

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

Financial liabilities at 31 December 2017	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	(2,226)	(367)	(91)	-	-	(2,684)
Debts evidenced by certificates	(961)	(1,609)	(10,412)	(15,128)	(13,591)	(41,701)
Other financial liabilities	(2)	(13)	(113)	(77)	(45)	(250)
At 31 December 2017	(3,189)	(1,989)	(10,616)	(15,205)	(13,636)	(44,635)
Trading derivative cash flows						
Net settling interest rate derivatives	(3)	(6)	(24)	(48)	(87)	(168)
Gross settling interest rate derivatives – outflow	(349)	(371)	(1,124)	(894)	(873)	(3,611)
Gross settling interest rate derivatives – inflow	322	327	1,105	843	913	3,510
Foreign exchange derivatives – outflow	(5,579)	(3,479)	(1,145)	-	-	(10,203)
Foreign exchange derivatives – inflow	5,448	3,428	1,125	-	-	10,001
Credit derivatives	-	-	-	(1)	(1)	(2)
At 31 December 2017	(161)	(101)	(63)	(100)	(48)	(473)
Hedging derivative cash flows						
Net settling interest rate derivatives	(2)	(7)	(32)	(104)	(38)	(183)
Gross settling interest rate derivatives – outflow	(142)	(123)	(334)	(619)	(1,426)	(2,644)
Gross settling interest rate derivatives – inflow	145	132	297	642	1,405	2,621
At 31 December 2017	1	2	(69)	(81)	(59)	(206)
Total financial liabilities at 31 December 2017	(3,349)	(2,088)	(10,748)	(15,386)	(13,743)	(45,314)
Other financial instruments						
Undrawn commitments						
Financial institutions	(2,621)	-	-	-	-	(2,621)
Non-financial institutions	(10,149)	-	-	-	-	(10,149)
At 31 December 2017	(12,770)	-	-	-	-	(12,770)

Financial liabilities at 31 December 2016	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	(2,207)	(309)	-	-	-	(2,516)
Debts evidenced by certificates	(1,927)	(4,444)	(5,736)	(13,638)	(12,089)	(37,834)
Other financial liabilities	(12)	(5)	(333)	(18)	(2)	(370)
At 31 December 2016	(4,146)	(4,758)	(6,069)	(13,656)	(12,091)	(40,720)
Trading derivative cash flows						
Net settling interest rate derivatives	(2)	(3)	(34)	(53)	(94)	(186)
Gross settling interest rate derivatives – outflow	(13)	(360)	(381)	(871)	(284)	(1,909)
Gross settling interest rate derivatives – inflow	1	332	355	796	245	1,729
Foreign exchange derivatives – outflow	(1,147)	(1,845)	(888)	-	-	(3,880)
Foreign exchange derivatives – inflow	1,108	1,739	840	-	-	3,687
At 31 December 2016	(53)	(137)	(108)	(128)	(133)	(559)
Hedging derivative cash flows						
Net settling interest rate derivatives	(200)	11	(602)	(482)	(53)	(1,326)
Gross settling interest rate derivatives – outflow	(28)	(308)	(1,258)	(2,695)	(2,432)	(6,721)
Gross settling interest rate derivatives – inflow	37	268	1,055	2,264	2,044	5,668
At 31 December 2016	(191)	(29)	(805)	(913)	(441)	(2,379)
Total financial liabilities at 31 December 2016	(4,390)	(4,924)	(6,982)	(14,697)	(12,665)	(43,658)
Other financial instruments						
Undrawn commitments						
Financial institutions	(2,361)	-	-	-	-	(2,361)
Non-financial institutions	(9,714)	-	-	-	-	(9,714)
At 31 December 2016	(12,075)	-	-	-	-	(12,075)

E. 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 the fact 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. The callable shares were issued subject to redemption in accordance with the terms of Resolution No. 128. At 31 December 2017, €8.9 billion of the callable capital increase had been subscribed (2016: €8.9 billion).

At the May 2015 Annual Meeting the Board of Governors reviewed the capital stock of the Bank pursuant to Article 5.3 of the Agreement and resolved that the projected capital stock is appropriate for the 2016-20 period, in the context of the approval of the Bank's Strategic and Capital Framework 2016-20. The Board of Governors further resolved that no callable capital shares would be redeemed and that the redemption and cancellation provisions in Resolution No. 128 be removed. Finally, the Board of Governors resolved that the adequacy of the Bank's capital would next be reviewed at the 2020 Annual Meeting (Resolutions No. 181, 182 and 183).

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 the countries in which it invests to the total amount of the Bank's unimpaired subscribed capital, reserves and surpluses. This capital base incorporates unimpaired subscribed capital (including callable capital), the unrestricted general reserves, loan loss reserve, special reserve and adjustments for general loan impairment provisions on Banking exposures and unrealised equity losses. Reflecting a change in interpretation in 2015, specific provisions are not included in the statutory capital base. The capital base for these purposes amounted to €40.3 billion[54] at 31 December 2017 after 2017 net income allocation decisions (2016: €39.7 billion[55]).

The Bank interprets the gearing ratio on a "disbursed Banking assets" or "operating assets" basis. To ensure consistency with the statutory capital base, specific provisions are deducted from total operating assets for the purposes of the ratio. At 31 December 2017, the Bank's gearing ratio on an aggregated basis was 70 per cent (2016: 73 per cent). 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. No capital utilisation limits were breached during the year (2016: none).

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

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

One of the main objectives of the Capital Adequacy 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 and reserves.

At 31 December 2017 the ratio of required capital to available capital was 70 per cent (2016: 77 per cent) compared with a policy threshold for this ratio of 90 per cent. The Bank's risk-based capital requirement 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 2017, the ratio of members' equity to total assets was 29 per cent (restated 2016: 28 per cent) and the ratio of members' equity to Banking assets was 60 per cent (restated 2016: 56 per cent).

[54] Deductions are made to exclude revaluation reserves related to Banking assets (as operating assets are considered at cost).

[55] 2016 capital figure has not been restated to account for the change in accounting policy described in note 32 on page 80.

F. Fair value of financial assets and liabilities

Classification and fair value of financial assets and liabilities

Financial assets at 31 December 2017	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	916	916
– Derivative financial instruments	3,677	3,677
– Banking loans at fair value through profit or loss	372	372
– Banking portfolio: Share investments at fair value through profit or loss	4,834	4,834
– Treasury portfolio: Share investments at fair value through other comprehensive income	76	76
	9,875	9,875
Financial assets measured at amortised cost:[56]		
– Placements with and advances to credit institutions	14,605	14,605
– Debt securities	9,465	9,512
– Other financial assets	352	352
– Banking loan investments at amortised cost	21,780	22,314
	46,202	46,783
Total	56,077	56,658

Financial assets at 31 December 2016	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	926	926
– Derivative financial instruments	4,319	4,319
– Banking loans at fair value through profit or loss	313	313
– Banking portfolio: Share investments at fair value through profit or loss	5,265	5,265
– Treasury portfolio: Share investments at fair value through other comprehensive income	75	75
	10,898	10,898
Financial assets measured at amortised cost:		
– Placements with and advances to credit institutions	14,110	14,110
– Debt securities	8,981	9,000
– Other financial assets	214	214
– Banking loan investments at amortised cost	21,841	22,610
	45,146	45,934
Total	56,044	56,832

[56] With the exception of debt securities and loan investments, the fair value for the other amortised cost assets approximates to their carrying value due to the short-dated nature of these assets.

Financial liabilities at 31 December 2017	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	-	-	-	(2,650)	(2,650)	(2,650)
Debts evidenced by certificates	-	-	-	(35,116)	(35,116)	(34,964)
Derivative financial instruments	(392)	(77)	(1,355)	-	(1,824)	(1,824)
Other financial liabilities	-	-	-	(431)	(431)	(431)
Total financial liabilities	(392)	(77)	(1,355)	(38,197)	(40,021)	(39,869)

Financial liabilities at 31 December 2016	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	-	-	-	(2,478)	(2,478)	(2,478)
Debts evidenced by certificates	-	-	-	(35,531)	(35,531)	(35,429)
Derivative financial instruments	(403)	(50)	(1,717)	-	(2,170)	(2,170)
Other financial liabilities	-	-	-	(540)	(540)	(540)
Total financial liabilities	(403)	(50)	(1,717)	(38,549)	(40,719)	(40,617)

At 31 December 2017, the Bank's balance sheet approximates to fair value in all financial asset and liability categories, with the exception of loan investments at amortised cost.

The amortised cost instruments held within placements with and advances to credit institutions, other financial assets, amounts owed to credit institutions, and other financial liabilities are all deemed to have amortised cost values approximating their fair value, being primarily simple, short-term instruments. They are classified as having Level 2 inputs (see fair value hierarchy, below) as the Bank's assessment of their fair value is based on the observable market valuation of similar assets and liabilities.

Amortised cost debt securities are valued using Level 2 inputs. The basis of their fair value 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 using Level 3 inputs 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 borrowings raised through the issuance of commercial paper and bonds.[57] The fair value of the Bank's issued bonds is determined using discounted cash flow models and therefore relies on Level 3 inputs. Due to the short-tenor nature of commercial paper, amortised cost approximates fair value. The fair value of the Bank's issued commercial paper is determined based on the observable market valuation of similar assets and liabilities and therefore relies on Level 2 inputs.

Fair value hierarchy

IFRS 13 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 SuperDerivatives 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.

[57] Adjusted for hedge accounting as applicable.

The table below provides information at 31 December 2017 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 2017			
	Level 1 € million	Level 2 € million	Level 3 € million	Total € million
Debt securities	-	916	-	916
Derivative financial instruments	-	3,215	462	3,677
Banking loans	-	-	372	372
Share investments (Banking portfolio)	1,548	-	3,286	4,834
Share investments (Treasury portfolio)	-	76	-	76
Total financial assets at fair value	1,548	4,207	4,120	9,875
Derivative financial instruments	-	(1,747)	(77)	(1,824)
Total financial liabilities at fair value	-	(1,747)	(77)	(1,824)

	At 31 December 2016			
	Level 1 € million	Level 2 € million	Level 3 € million	Total € million
Debt securities	-	926	-	926
Derivative financial instruments	-	3,742	577	4,319
Banking loans	-	-	313	313
Share investments (Banking portfolio)	1,810	-	3,455	5,265
Share investments (Treasury portfolio)	-	75	-	75
Total financial assets at fair value	1,810	4,743	4,345	10,898
Derivative financial instruments	-	(2,119)	(51)	(2,170)
Total financial liabilities at fair value	-	(2,119)	(51)	(2,170)

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 2017.

	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 2016	577	313	3,455	4,345	(51)	(51)
Total (losses)/gains for the year ended 31 December 2017 in:						
Net (loss)/gains	(82)	(2)	157	73	(26)	(26)
Deferred profit	56	-	-	56	-	-
Purchases/issues	-	106	389	495	-	-
Sales/settlements	(89)	(56)	(667)	(812)	-	-
Write offs	-	(21)	-	(21)	-	-
Reclassification	-	32	-	32	-	-
Transfers out of Level 3		-	(48)	(48)	-	-
Balance at 31 December 2017	462	372	3,286	4,120	(77)	(77)
Total gains/(losses) for the period included in net profit from assets and liabilities held at 31 December 2017	34	(14)	100	120	(39)	(39)

	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 2015	498	339	3,214	4,051	(78)	(78)
Total gains/(losses) for the year ended 31 December 2016 in:						
Net profit/(loss)	180	48	(250)	(22)	27	27
Deferred profit	25	-	-	25	-	-
Purchases/issues	-	108	746	854	-	-
Sales/settlements	(126)	(233)	(303)	(662)	-	-
Write offs	-	-	(25)	(25)	-	-
Reclassification	-	51	(8)	43	-	-
Transfers out of Level 3	-	-	81	81	-	-
Balance at 31 December 2016	577	313	3,455	4,345	(51)	(51)
Total gains/(losses) for the period included in net profit for assets and liabilities held at 31 December 2016	260	38	(147)	151	(48)	(48)

Transfers into and out of Level 3 for Banking share investments relate to listed investments that switch from/(to) an actively traded market.

Level 3 – sensitivity analysis

The table below presents the Level 3 financial instruments carried at fair value at 31 December 2017, the main valuation models/techniques[58] used in the valuation of these financial instruments and the estimated increases or decreases in fair value based on reasonably possible alternative assumptions:

	Main valuation models/techniques	Impact on net profit in 2017 Carrying amount € million	 Favourable change € million	 Unfavourable change € million
Treasury derivative financial instruments	DCF models	7	-	(1)
Banking loans	DCF and option pricing models	372	12	(17)
Banking share investments and associated derivatives[59]	NAV and EBITDA multiples, DCF models, compounded interest and option pricing models	3,664	760	(732)
At 31 December		4,043	772	(750)

	Main valuation models/techniques	Impact on net profit in 2016 Carrying amount € million	 Favourable change € million	 Unfavourable change € million
Treasury derivative financial instruments	DCF models	9	-	(1)
Banking loans	DCF and option pricing models	313	11	(20)
Banking share investments and associated derivatives	NAV and EBITDA multiples, DCF models, compounded interest and option pricing models	3,972	520	(573)
At 31 December		4,294	531	(594)

Treasury debt securities and derivative financial instruments

The Bank's derivative instruments held within the Treasury portfolio are valued through DCF models. Valuations are reconciled to counterparty statements on a daily 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.

The Bank's debt securities are priced via a third party market data service, screen-based services such as Bloomberg or using broker quotes.

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 DCF 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 determine the fair value of these financial instruments are NAV multiples, EBITDA multiples and DCF models.

NAV multiples are most commonly applied to bank investments and equity funds. Recent transactions within sectors are also considered where available. 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 analysis was performed by determining reasonable alternative valuations using sales, EBITDA, price-to-earnings multiples methods, as well as industry specific methods like multiples based on production capacities. Further, within a given method valuation ranges were determined by using bottom and top quartile multiples. For DCF models sensitivity analysis was performed by changing certain underlying assumptions (for example, an increase or decrease in the discount rate).

[58] NAV = net asset value; EBITDA = earnings before interest, tax, depreciation and amortisation; DCF = discounted cash flow.

[59] Banking share investments typically have an attached put and/or call option derivative. As such, any change in the underlying value of the equity may be offset by the change in the value of the derivative. For this reason, Banking share investments and the associated derivatives have been combined for the sensitivity analysis.

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 2017, the Bank's members comprised 66 countries, together with the European Union 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 in which the Bank invests 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 President, the Bank's chief operating decision-maker. On this basis, Banking and Treasury operations have been identified as the operating segments.

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 2017 and 31 December 2016 is as follows:

	Banking 2017 € million	Treasury 2017 € million	Aggregated 2017 € million	Restated Banking 2016 € million	Treasury 2016 € million	Restated[60] Aggregated 2016 € million
Interest income	974	173	1,147	966	126	1,092
Other income	411	49	460	524	90	614
Total segment revenue	1,385	222	1,607	1,490	216	1,706
Interest expense and similar charges	(286)	(143)	(429)	(260)	23	(237)
Net interest income/(expense) on derivatives	-	36	36	-	(81)	(81)
General administrative expenses	(371)	(24)	(395)	(418)	(27)	(445)
Depreciation and amortisation	(24)	(2)	(26)	(21)	(1)	(22)
Segment result before provisions and hedges	704	89	793	791	130	921
Fair value movement on non-qualifying and ineffective hedges	-	(20)	(20)	-	131	131
Provisions for impairment of loan investments and guarantees	(1)	-	(1)	(60)	-	(60)
Net profit for the year	703	69	772	731	261	992
Transfers of net income approved by the Board of Governors			(180)			(181)
Net profit after transfers approved by the Board of Governors			592			811
Segment assets						
Total assets	27,819	28,374	56,193	28,322	27,955	56,277
Segment liabilities						
Total liabilities	328	39,694	40,022	416	40,303	40,719

[60] Explained in note 32 on page 80.

Segment revenues – Geographic

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

	Segment revenue 2017 € million	Restated[61] Segment revenue 2016 € million
Advanced countries[62]	270	164
Early/Intermediate countries[63]	761	606
Russia	(38)	499
SEMED	107	58
Turkey	285	163
OECD[64]	222	216
Total	1,607	1,706

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

3. Net interest income

	2017 € million	Restated[65] 2016 € million
Banking loans at amortised cost	974	966
Debt securities	101	75
Reverse repurchase agreements	17	3
Cash and short-term funds	55	46
Other	-	2
Interest and similar income	1,147	1,092
Debts evidenced by certificates	(360)	(194)
Amounts owed to credit institutions	(69)	(42)
Other	-	(1)
Interest expense and similar charges	(429)	(237)
Net interest income/(expense) on derivatives	36	(81)
Net interest income	754	774

Interest income accrued on impaired financial assets during 2017 was €16 million (2016: €31 million).[66]

[61] Explained in note 32 on page 80.

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

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

[64] Other member countries of the Organisation for Economic Co-operation and Development which are not classed as Advanced or Early/Intermediate. www.oecd.org/about/membersandpartners/

[65] Explained in note 32 on page 80.

[66] This interest income equates to the unwinding of the discount on expected future cash flows from impaired financial assets.

4. Net fee and commission income

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

	2017 € million	Restated[67] 2016 € million
Front end and commitment charges	48	51
Syndication and agency fees	3	4
Administration fees	4	5
Prepayment fees	3	4
Trade finance fees	8	8
Other	8	4
Equity fees	6	4
Fee and commission income	80	80
Equity fees	(2)	(1)
Other	(4)	(2)
Fee and commission expense	(6)	(3)
Net fee and commission income	74	77

Front-end and appraisal fees of €62 million (2016: €69 million) received in 2017, together with related direct costs of €4 million (2016: €4 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 2017, €48 million (2016: €49 million) of previously deferred fees and direct costs were recognised in interest income.

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

	2017 € million	2016 € million
Net realised gains from share investments and equity-related derivatives	40	21
Net unrealised gains from share investments and equity-related derivatives	107	305
Net gains from share investments at fair value through profit or loss	147	326

On exit of an equity investment, the cumulative gain/loss is realised with a corresponding reversal of the cumulative unrealised gain/loss recorded prior to the exit.

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

	2017 € million	2016 € million
Loan write-off	(21)	-
Net movement in unrealised gains from changes in fair value	25	8
Net unrealised foreign exchange (losses)/gains	(6)	1
Net (losses)/gains from loans at fair value through profit or loss	(2)	9

7. Net gains from Treasury assets held at amortised cost

	2017 € million	2016 € million
Net realised gains from debt securities at amortised cost	2	6
Net gains from Treasury assets held at amortised cost	2	6

During the year the Bank sold €556 million of debt securities held at amortised cost (2016: €1.3 billion).

[67] As explained in note 32 on page 80.

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

	2017 € million	2016 € million
Debt buy-backs and termination of related derivatives	-	34
Balance sheet management	42	43
Internally managed dealing portfolio designated at fair value	5	7
Net gains from Treasury activities at fair value through profit or loss	47	84

Treasury balance sheet management activities are primarily concerned with the management of market and currency risks across the Bank's balance sheet together with short-term liquidity management. The financial performance of these activities is affected by the currency basis spreads used in the valuation of swaps through which Treasury funds the Bank's local currency denominated loan portfolio.[68] These swaps are used for funding purposes and so will be held to maturity; any unrealised valuation losses or gains caused by the volatility in currency basis spreads will reverse over time. A €13 million gain was recognised in 2017 relating to these spreads (2016: €12 million loss).

The profit deriving from the Bank's debt buyback activities is unpredictable as it typically occurs through the Bank responding to investors looking to exit private placement holdings of the Bank's debt.

9. Fair value movement on non-qualifying and ineffective hedges

The hedging practices and accounting treatment are disclosed under "Derivative financial instruments and hedge accounting" on page 22 in the Accounting Policies section of this report.

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 if the hedging relationships were 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 the 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 gain of €13 million, comprising gains of €85 million on the derivative hedging instruments and losses of €72 million on the hedged items (2016: a gain of €89 million comprising gains of €514 million on the derivative hedging instruments and losses of €425 million 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 €33 million (2016: gain of €42 million).

The combined effect of all the hedging activities described above was a loss of €20 million for the year (2016: gain of €131 million).

Cash flow hedges

The Bank hedges on an annual basis to minimise the exchange rate risk associated with incurring administrative expenses in pound sterling. In 2017 no gain or loss was recognised as ineffectiveness in the income statement arising from cash flow hedges, as was the case in 2016.

[68] The loans funded in this manner are predominantly denominated in Russian rouble and Turkish lira.

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

(Charge)/release for the year	2017 € million	2016 € million
Portfolio provisions for unidentified impairment of loan investments		
Non-sovereign loan investments	3	3
Sovereign loan investments	10	4
Specific provisions for identified impairment of loan investments[69]	(16)	(64)
Provisions for impairment of Banking loan investments at amortised cost	(3)	(57)

Movement in provisions	2017 € million	2016 € million
At 1 January	(1,044)	(1,083)
Charge for the year to the income statement[70]	(3)	(57)
Reversal of accrued interest income on newly impaired loans	2	3
Unwinding of the discount relating to identified impairment of assets	16	29
Foreign exchange adjustments	64	(15)
Release against amounts written off	115	79
At 31 December	(850)	(1,044)
Analysed between		
Portfolio provisions for unidentified impairment of loan investments:		
Non-sovereign loan investments	(230)	(250)
Sovereign loan investments	(18)	(29)
Specific provisions for identified impairment of loan investments	(602)	(765)
At 31 December	(850)	(1,044)

11. General administrative expenses

	2017 € million	2016 € million
Personnel costs	(274)	(311)
Overhead expenses	(125)	(138)
General administrative expenses	(399)	(449)
Deferral of direct costs related to loan origination	4	4
Net general administrative expenses	(395)	(445)

The Bank's expenses are predominantly incurred in pound sterling. The pound sterling equivalent of the Bank's general administrative expenses, excluding depreciation and amortisation, totalled £345 million (2016: £326 million). £13 million of the increased expenditure relates to costs under the Bank's Operational Effectiveness and Efficiency Programme, with the remainder mostly related to inflationary increases within staff costs.

Direct costs of €4 million (2016: €4 million) relating to loan origination in 2017 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.

[69] Comprised of €122 million of new provisions against €106 million of released provisions (2016: €192 million against €128 million respectively).

[70] Excludes provisions for guarantees which are recorded in other assets.

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

Audit and assurance services	2017 € 000	2016 € 000
Services as auditor of the Bank	(295)	(308)
Internal controls framework assurance	(140)	(147)
Retirement plan audit	(24)	(25)
Tax recovery audit	(11)	(12)
Audit and assurance services	(470)	(492)

The fall in the fees for audit and assurance services paid to the Bank's external auditor from 2016 to 2017 is attributable to movements in the value of pound sterling. The pound sterling equivalent of these fees increased to £413,000 (2016: £402,000).

12. Placements with and advances to credit institutions

Analysed between	2017 € million	2016 € million
Cash and cash equivalents	6,271	8,517
Other current placements and advances	8,334	5,593
At 31 December	14,605	14,110

Cash and cash equivalents are those placements and advances which have an original 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

	2017 € million	2016 € million
Debt securities at fair value through profit or loss	916	926
Debt securities at amortised cost	9,465	8,981
At 31 December	10,381	9,907
Analysed between		
Current	3,061	3,394
Non-current	7,320	6,513
At 31 December	10,381	9,907

There were no impairment losses relating to debt securities in 2017 (2016: €nil).

14. Other financial assets

	2017 € million	2016 € million
Fair value of derivatives designated as fair value hedges	2,891	2,931
Fair value of derivatives designated as cash flow hedges	1	-
Fair value of portfolio derivatives not designated as hedges	330	821
Fair value of derivatives held in relation to the banking portfolio	455	567
Interest receivable	217	218
Paid-in capital receivable	10	12
Other	125	(16)
At 31 December	4,029	4,533
Analysed between		
Current	1,061	954
Non-current	2,968	3,579
At 31 December	4,029	4,533

15. Banking loan investments at amortised cost

	2017 Sovereign loans € million	2017 Non-sovereign loans € million	2017 Total loans € million	Restated 2016 Sovereign loans € million	Restated 2016 Non-sovereign loans € million	Restated[71] 2016 Total loans € million
At 1 January	4,019	18,993	23,012	3,050	18,887	21,937
Movement in fair value revaluation[72]	-	(3)	(3)	-	21	21
Disbursements	1,477	7,027	8,504	2,185	7,561	9,746
Repayments and prepayments	(1,327)	(6,210)	(7,537)	(1,230)	(7,646)	(8,876)
Remeasurement of previously impaired loans	-	30	30	-	-	-
Foreign exchange movements	(96)	(1,123)	(1,219)	23	262	285
Movement in net deferral of front end fees and related direct costs	(2)	(8)	(10)	(9)	(6)	(15)
Reclassification	-	(32)	(32)	-	(7)	(7)
Written off	-	(115)	(115)	-	(79)	(79)
At 31 December	4,071	18,559	22,630	4,019	18,993	23,012
Impairment at 31 December	(18)	(832)	(850)	(29)	(1,015)	(1,044)
Total net of impairment at 31 December	4,053	17,727	21,780	3,990	17,978	21,968
Analysed between						
Current			2,854			2,998
Non-current			18,926			18,970
Total net of impairment at 31 December	4,053	17,727	21,780	3,990	17,978	21,968

At 31 December 2017 the Bank categorised 86 loan investments at amortised cost as impaired, with operating assets totalling €848 million (2016: 101 loans totalling €1.2 billion).

[71] As explained in note 32 on page 80.

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

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

Non-sovereign loans	2017 € million	2016 € million
At 1 January	313	339
Movement in fair value revaluation	21	13
Disbursements	106	108
Repayments and prepayments	(56)	(233)
Foreign exchange movements	(23)	35
Reclassification	32	51
Written off	(21)	-
At 31 December	372	313
Analysed between		
Current	19	31
Non-current	353	282
At 31 December	372	313

17. Share investments at fair value through profit or loss

	2017 Fair value Unlisted € million	2017 Fair value Listed € million	2017 Fair value Total € million	2016 Fair value Unlisted € million	2016 Fair value Listed € million	2016 Fair value Total € million
Outstanding disbursements						
At 1 January	4,238	1,896	6,134	4,162	1,966	6,128
Transfer between unlisted and listed	(76)	76	-	(179)	179	-
Disbursements	379	140	519	709	65	774
Disposals	(715)	(432)	(1,147)	(421)	(314)	(735)
Reclassification	-	-	-	(25)	-	(25)
Written off	-	-	-	(8)	-	(8)
At 31 December	3,826	1,680	5,506	4,238	1,896	6,134
Fair value adjustment						
At 1 January	(1,080)	211	(869)	(1,068)	(27)	(1,095)
Transfer between unlisted and listed	28	(28)	-	63	(63)	-
Movement in fair value revaluation	291	(94)	197	(75)	301	226
At 31 December	(761)	89	(672)	(1,080)	211	(869)
Fair value at 31 December	3,065	1,769	4,834	3,158	2,107	5,265

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 2017 (venture capital associates), is detailed under note 29, “Related parties” on page 78.

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

Treasury holds two strategic share investments for the purposes of accessing hedging and risk management products in the currencies of underdeveloped markets. These are in the Currency Exchange Fund N.V. and the Frontier Clearing Fund. The Bank also has a purely nominal shareholding in SWIFT as membership is required to participate in this international payments system.

	2017 € million	2016 € million
Share investment designated at fair value through other comprehensive income		
The Currency Exchange Fund N.V.	69	67
The Frontier Clearing Fund	7	8
SWIFT	-	-
At 31 December	76	75

No dividend income was received on these share investments during 2017 (2016: €nil).

19. Intangible assets

	Computer software development costs 2017 € million	Computer software development costs 2016 € million
Cost		
At 1 January	115	102
Additions	14	16
Disposals	-	(3)
At 31 December	129	115
Amortisation		
At 1 January	(52)	(39)
Charge	(15)	(13)
Disposals	-	-
At 31 December	(67)	(52)
Net book value at 31 December	62	63

20. Property, technology and equipment

	Property 2017 € million	Property under construction 2017 € million	Technology and equipment 2017 € million	Other 2017 € million	Total 2017 € million	Property 2016 € million	Property under construction 2016 € million	Technology and equipment 2016 € million	Other 2016 € million	Total 2016 € million
Cost										
At 1 January	77	-	18	-	95	65	15	18	-	98
Additions	1	2	1	18	22	4	3	2	-	9
Transfers	-	-	-	-	-	13	(13)	-	-	-
Disposals	-	-	-	-	-	(5)	(5)	(2)	-	(12)
At 31 December	78	2	19	18	117	77	-	18	-	95
Depreciation										
At 1 January	(39)	-	(13)	-	(52)	(35)	-	(13)	-	(48)
Charge	(7)	-	(2)	(2)	(11)	(8)	-	(1)	-	(9)
Disposals	-	-	-	-	-	4	-	1	-	5
At 31 December	(46)	-	(15)	(2)	(63)	(39)	-	(13)	-	(52)
Net book value at 31 December	32	2	4	16	54	38	-	5	-	43

21. Borrowings

	2017 € million	2016 € million
Amounts owed to credit institutions and other third parties		
Amounts owed to credit institutions	(431)	(420)
Amounts held as collateral	(1.393)	(1,343)
Amounts managed on behalf of third parties[73]	(826)	(715)
At 31 December	(2,650)	(2,478)
Of which current:	(2,627)	(2,478)

22. 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.

	Bond denominations 2017 € million	Currency after swap 2017 € million	Bond denominations 2016 € million	Currency after swap 2016 € million
Armenian dram	(2)	(2)	-	-
Australian dollar	(830)	(42)	(810)	-
Canadian dollar	(32)	-	(34)	-
Egyptian pound	(8)	(8)	-	-
Euro	(3,705)	(5,663)	(3,553)	(5,968)
Georgian lari	(145)	(145)	(47)	(47)
Hungarian forint	(4)	(4)	-	-
Japanese yen	(1,792)	-	(1,985)	-
Kazakh tenge	(603)	(554)	(200)	(200)
Mexican peso	(113)	-	(120)	-
New Turkish lira	(920)	-	(768)	-
New Zealand dollar	(7)	-	(15)	-
Norwegian krone	-	-	(100)	-
Pound sterling	(2,005)	(1,132)	(2,534)	(1,609)
Romanian leu	(124)	(97)	(57)	(26)
Russian rouble	(505)	(137)	(653)	(202)
Serbian dinar	(21)	(21)	(20)	(20)
Slovak koruna	-	-	(43)	-
South African rand	(328)	-	(403)	-
Tajik somoni	(1)	(1)	-	-
United States dollar	(23,971)	(27,310)	(24,189)	(27,459)
At 31 December	(35,116)	(35,116)	(35,531)	(35,531)

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	2017 € million	2016 € million
Current	(12,348)	(11,692)
Non-current	(22,768)	(23,839)
Debts evidenced by certificates at 31 December	(35,116)	(35,531)

During the year the Bank redeemed €170 million of bonds and medium-term notes prior to maturity (2016: €1.6 billion), generating no net gains or losses (2016: €34 million gain).

[73] See note 30 on page 78 for details of third parties.

The table below provides a reconciliation of the movements in debts evidenced by certificates for the year ended 31 December 2017, including both changes arising from cash flows and non-cash changes.

For the year ended 31 December 2017	2016 € million	Cash flows € million	Fair value movements € million	Foreign exchange movements € million	Deals pending settlement € million	2017 € million
Debts evidenced by certificates	35,531	2,752	501	(3,622)	(46)	35,116

	2015 € million	Cash flows € million	Fair value movements € million	Foreign exchange movements € million	Deals pending settlement € million	2016 € million
Debts evidenced by certificates	34,280	198	615	410	28	35,531

23. Other financial liabilities

	2017 € million	2016 € million
Fair value of derivatives designated as fair value hedges	(1,355)	(1,715)
Fair value of derivatives designated as cash flow hedges	-	(2)
Fair value of portfolio derivatives not designated as hedges	(392)	(403)
Fair value of other derivatives held in relation to the banking portfolio	(77)	(50)
Interest payable	(171)	(157)
Net income allocations payable	-	(220)
Amounts payable to the Equity Participation Fund	(42)	-
Other	(218)	(163)
At 31 December	(2,255)	(2,710)

Analysed between	2017 € million	2016 € million
Current	(898)	(1,043)
Non-current	(1,357)	(1,667)
At 31 December	(2,255)	(2,710)

24. Subscribed capital

	2017 Number of shares	2017 Total € million	2016 Number of shares	2016 Total € million
Authorised shared capital	3,000,000	30,000	3,000,000	30,000
of which				
Subscribed capital	2,972,307	29,723	2,970,335	29,703
Unsubscribed capital	27,693	277	29,665	297
At 31 December	3,000,000	30,000	3,000,000	30,000

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. These shares were originally subject to redemption in accordance with the terms of Resolution No. 128, but such provisions were removed under the terms of Resolution No. 183 approved by the Board of Governors at the 2015 Annual Meeting. 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, was 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 66 countries 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 and the SEMED region.

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.

On 26 April 2017, Morocco increased its subscription to the Bank's capital stock by 986 shares (807 callable shares and 179 paid-in shares). A capital contribution of €1.79 million was made for the paid-in shares.

On 14 July 2017, the Republic of Lebanon was admitted to membership of the Bank, subscribing to 986 shares of the Bank's capital stock (807 callable shares and 179 paid-in shares). A capital contribution of €1.79 million was made for the paid-in shares.

A statement of capital subscriptions showing the amount of paid-in and callable shares subscribed to by each member, together with the number of 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.

Statement of capital subscriptions

At 31 December 2017 Members	Total shares (number)	Resulting votes[74] (number)	Total capital € million	Callable capital € million	Paid-in capital € million
Albania	3,001	2,511	30.01	23.75	6.26
Armenia	1,499	1,499	14.99	11.86	3.13
Australia	30,014	30,014	300.14	237.54	62.60
Austria	68,432	68,432	684.32	541.59	142.73
Azerbaijan	3,001	3,001	30.01	23.75	6.26
Belarus	6,002	6,002	60.02	47.50	12.52
Belgium	68,432	68,432	684.32	541.59	142.73
Bosnia and Herzegovina	5,071	5,071	50.71	40.14	10.57
Bulgaria	23,711	23,711	237.11	187.65	49.46
Canada	102,049	102,049	1,020.49	807.64	212.85
China	2,900	2,900	29.00	23.75	5.25
Croatia	10,942	10,942	109.42	86.60	22.82
Cyprus	3,001	3,001	30.01	23.75	6.26
Czech Republic	25,611	25,611	256.11	202.69	53.42
Denmark	36,017	36,017	360.17	285.05	75.12
Egypt	2,101	2,101	21.01	14.75	6.26
Estonia	3,001	3,001	30.01	23.75	6.26
European Investment Bank	90,044	90,044	900.44	712.63	187.81
European Union	90,044	90,044	900.44	712.63	187.81
Finland	37,518	37,518	375.18	296.92	78.26
Former Yugoslav Republic of Macedonia	1,762	1,762	17.62	13.31	4.31
France	255,651	255,651	2,556.51	2,023.28	533.23
Georgia	3,001	3,001	30.01	23.75	6.26
Germany	255,651	255,651	2,556.51	2,023.28	533.23
Greece	19,508	19,508	195.08	154.39	40.69
Hungary	23,711	23,711	237.11	187.65	49.46
Iceland	3,001	3,001	30.01	23.75	6.26
Ireland	9,004	9,004	90.04	71.26	18.78
Israel	19,508	19,508	195.08	154.39	40.69
Italy	255,651	255,651	2,556.51	2,023.28	533.23
Japan	255,651	255,651	2,556.51	2,023.28	533.23
Jordan	986	986	9.86	8.07	1.79
Kazakhstan	6,902	6,902	69.02	54.62	14.40
Korea, Republic of	30,014	30,014	300.14	237.54	62.60
Kosovo	580	580	5.80	4.75	1.05
Kyrgyz Republic	2,101	1,010	21.01	14.75	6.26
Latvia	3,001	3,001	30.01	23.75	6.26
Lebanon	986	986	9.86	8.07	1.79
Liechtenstein	599	599	5.99	4.74	1.25
Lithuania	3,001	3,001	30.01	23.75	6.26
Luxembourg	6,002	6,002	60.02	47.50	12.52
Malta	210	210	2.10	1.47	0.63
Mexico	4,501	4,501	45.01	34.50	10.51
Moldova	3,001	3,001	30.01	23.75	6.26
Mongolia	299	299	2.99	2.36	0.63

[74] The voting power of members who have failed to pay any part of the amount due in respect of their obligations in relation to paid-in shares has been adjusted down by a percentage corresponding to the percentage which the unpaid amount due bears to the total amount of paid-in shares subscribed to by that member. Consequently the overall number of exercisable votes is lower than the total amount of subscribed shares.

Statement of capital subscriptions (continued)

At 31 December 2017	Total shares (number)	Resulting votes (number)	Total capital € million	Callable capital € million	Paid-in capital € million
Montenegro	599	599	5.99	4.74	1.25
Morocco	2,464	2,464	24.64	19.35	5.29
Netherlands	74,435	74,435	744.35	589.10	155.25
New Zealand	1,050	1,050	10.50	7.00	3.50
Norway	37,518	37,518	375.18	296.92	78.26
Poland	38,418	38,418	384.18	304.05	80.13
Portugal	12,605	12,605	126.05	99.76	26.29
Romania	14,407	14,407	144.07	114.02	30.05
Russia	120,058	120,058	1,200.58	950.17	250.41
Serbia	14,031	14,031	140.31	111.05	29.26
Slovak Republic	12,807	12,807	128.07	101.36	26.71
Slovenia	6,295	6,295	62.95	49.82	13.13
Spain	102,049	102,049	1,020.49	807.64	212.85
Sweden	68,432	68,432	684.32	541.59	142.73
Switzerland	68,432	68,432	684.32	541.59	142.73
Tajikistan	2,101	602	21.01	14.75	6.26
Tunisia	986	986	9.86	8.07	1.79
Turkey	34,515	34,515	345.15	273.16	71.99
Turkmenistan	210	164	2.10	1.47	0.63
Ukraine	24,011	24,011	240.11	190.03	50.08
United Kingdom	255,651	255,651	2,556.51	2,023.28	533.23
United States of America	300,148	300,148	3,001.48	2,375.44	626.04
Uzbekistan	4,412	4,134	44.12	30.97	13.15
Capital subscribed by members	2,972,307	2,968,903	29,723.07	23,512.10	6,210.97

25. Reserves and retained earnings

	2017 € million	Restated[75] 2016 € million
Special reserve		
At 1 January	306	306
At 31 December	306	306
Loan loss reserve		
At 1 January	1,171	1,159
Transferred from retained earnings	48	12
At 31 December	1,219	1,171
Net income allocation		
At 1 January	9	10
Transferred from retained earnings	180	180
Distributions	(181)	(181)
At 31 December	8	9
General reserve – other reserve		
Revaluation reserve		
At 1 January	19	7
Net gains arising on revaluation of share investments at fair value through other comprehensive income	1	12
At 31 December	20	19
Hedging reserve – cash flow hedges		
At 1 January	(2)	-
Gains/(losses) from changes in fair value of hedges recognised in equity	3	(2)
At 31 December	1	(2)
Other		
At 1 January	225	219
Internal tax for the year	6	6
At 31 December	231	225
General reserve – other reserve at 31 December	252	242
General reserve – retained earnings		
At 1 January	7,623	6,803
Net profit before transfers of net income approved by the Board of Governors	772	992
Transferred to loan loss reserve	(48)	(12)
Transferred (to)/from net income allocation	(179)	(180)
Actuarial gains on defined benefit scheme	8	20
General reserve retained earnings at 31 December	8,176	7,623
Total reserves and retained earnings at 31 December	9,961	9,351

[75] As explained in note 32 on page 80.

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 for the foreseeable future the size of the special reserve was adequate.

In 2005, the Bank created a **loan loss reserve** (LLR) 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. In 2015 in a one-off allocation of €660 million was moved to the LLR. Following a period of more stable economic conditions, it was agreed during 2017 that this additional allocation will be released in full as of 1 January 2018. In 2017 the LLR increased by €48 million (2016: €12 million).

The **general reserve** represents all reserves except those amounts allocated to the 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 €122 million (2016: €116 million).

The **hedging reserve** includes foreign exchange revaluation amounts on designated hedging instruments held by the Bank for the purposes of hedging its estimated future pound sterling operating expenditure. At 31 December 2017 there was a gain of €1 million on these hedges. Revaluation gains or losses on these hedges are held in reserves until the related hedged expenditure is incurred at which time such gains or losses are released to profit or loss.

Reserves and retained earnings	2017 € million	Restated[76] 2016 € million
Special reserve	306	306
Loan loss reserve	1,219	1,171
Net income allocation	8	9
Unrealised gains	1,162	1,182
Total restricted reserves	2,695	2,668
Unrestricted general reserves	7,266	6,683
At 31 December	9,961	9,351

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 (2016: €3.0 billion).

During 2017, the Board of Governors approved the transfer of €180 million of net income to be allocated to other purposes. This amount was reflected in the 2017 income statement, below net profit from continuing operations. Under Resolution No. 203: *2016 Net Income Allocation.* €150 million was allocated to the EBRD Shareholder Special Fund (including an amount of €50 million required to support the Bank's specific operational response for refugee-hosting countries), €30 million was allocated as a contribution to the EBRD Trust Fund for the West Bank and Gaza.

[76] As explained in note 32 on page 80.

26. Undrawn commitments and guarantees

Analysis by instrument	2017 € million	2016 € million
Undrawn commitments		
Loans	10,692	10,029
Share investments	1,283	1,481
At 31 December	11,975	11,510
Guarantees		
Trade finance guarantees	694	455
Other guarantees	101	110
At 31 December	795	565
Undrawn commitments and guarantees at 31 December	12,770	12,075

27. Operating lease commitments

The Bank leases its Headquarters building in London and all of its Resident Office buildings in the countries in which it invests. 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 with the exception of the Headquarters lease. 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 most recent review was completed in 2016 from which there was no increase in rent. The next review is due to commence in 2021.

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

Payable	2017 € million	2016 € million
Not later than one year	29	27
Later than one year and not later than five years	88	96
Later than five years	-	16
At 31 December	117	139
Expenditure incurred in the current year	27	30

28. Staff retirement schemes

There are two retirement plans in operation. The FSP is a defined benefit scheme, to which only the Bank contributes. The MPP is a defined contribution scheme to which both the Bank and staff contribute, with Plan members making individual investment decisions. Both plans provide a lump sum benefit on leaving the Bank or at retirement age, meaning 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).

Defined benefit scheme

A qualified actuary performs a full actuarial valuation of the FSP at least every three years using the projected unit method, with a more high-level interim valuation performed annually. The most recent full valuation was carried out on 30 June 2017 which, for the purposes of IAS 19: Employee Benefits, was rolled forward to 31 December 2017. The present value of the defined benefit obligation and current service cost was calculated using the projected unit credit method.

The primary risk associated with the FSP is that its assets will fall short of its liabilities. This risk, encompassing market risk and credit risk associated with its investments and the liquidity risk associated with the payment of defined obligations as they fall due is borne by the Bank as the FSP is fully funded by the Bank. Responsibility for the investment strategy of the Scheme rests with the Retirement Plan Investment Committee (RPIC).

The aim of investment risk management is to minimise the risk of an overall reduction in the value of the FSP assets and to maximise the opportunity for gains across the whole investment portfolio. This is achieved through asset diversification to reduce exposure to market risk and credit risk to an acceptable level. For example, the non-cash and government bond investment holdings held by the FSP are fund-based investments that diversify their exposure to a number of underlying investments.

The RPIC passively manages credit risk by selecting investment funds that invest in gilts rather than corporate bonds. To mitigate against market risk the RPIC meets quarterly with the FSP's investment adviser to review the performance of all of the funds against their benchmarks. No asset-liability matching strategies are undertaken in relation to the FSP.

If, at the effective date of any actuarial valuation, the value of the plan's assets is less than the liabilities, it is the Bank's policy to review the funding status of the FSP and decide if a recovery plan should be put in place. Typically, such a recovery plan would include either anticipated investment out-performance, additional contributions from the Bank, or both. In the event that the plan assets are estimated to have fallen below 90 per cent of the defined benefit obligation (DBO), the Bank would expect to make additional contributions to restore the funding of the plan to at least 90 per cent as soon as possible.

Amounts recognised in the balance sheet are as follows:

	2017 € million	2016 € million
Fair value of plan assets	464	422
Present value of the defined benefit obligation	(461)	(418)
Net defined benefit asset at 31 December	3	4
Movement in the net defined benefit asset (included in "Other assets"):		
At 1 January	4	(13)
Contributions paid[77]	29	28
Total expense as below	(38)	(31)
Remeasurement effects recognised in other comprehensive income	8	20
At 31 December	3	4
The amounts recognised in the income statement are as follows:		
Current service cost	(38)	(33)
Foreign exchange movements	-	2
Total included in staff costs	(38)	(31)

[77] Contributions for 2018 are expected to be €30 million.

Principal actuarial assumptions used:

	2017	2016
Discount rate	2.35%	2.50%
Expected return on plan assets	2.35%	2.50%
Price inflation	3.25%	3.25%
Future salary increases	3.75%	3.25%
Weighted average duration of the defined benefit obligation	12 years	11 years

Sensitivity analysis on the key actuarial assumptions:

	Assumption	Sensitivity	(Decrease)/ Increase in DBO € million
Discount rate	2.35%	+/- 0.5% pa	(25)/27
Price inflation	3.25%	+/- 0.25% pa	13/(12)

These sensitivity analyses have been determined based on reasonably possible changes of the respective assumptions occurring at the end of the reporting period, while holding all other assumptions constant. The sensitivity analysis presented above may not be representative of the actual change in the defined benefit obligation as it is unlikely that the change in assumptions would occur in isolation of one another as the assumptions may be correlated.

Plan asset allocation	2017 Listed € million	2017 Unlisted € million	2017 Total € million	2016 Listed € million	2016 Unlisted € million	2016 Total € million
Equities	214	48	262	200	41	241
Index-linked bonds	162	-	162	144	-	144
Other	-	40	40	-	37	37
Fair value of plan assets	376	88	464	344	78	422

Changes in the present value of the defined benefit obligation are as follows:	2017 € million	2016 € million
Present value of defined benefit obligation at 1 January	(418)	(403)
Service cost	(38)	(33)
Interest cost	(10)	(12)
Effect of exchange rate movement	13	57
Actuarial (loss)/gain arising due to changes in assumptions[78]	(27)	(42)
Benefits paid	19	15
Present value of defined benefit obligation at 31 December	(461)	(418)

Changes in the fair value of plan assets are as follows:	2017 € million	2016 € million
Present value of plan assets at 1 January	422	390
Interest income on plan assets	10	12
Return on assets greater than discount rate	35	62
Effect of exchange rate movement	(13)	(55)
Contributions paid	29	28
Benefits paid	(19)	(15)
Present value of plan assets at 31 December	464	422

[78] All actuarial losses relate to changes in financial assumptions.

Experience gains and losses	2017 € million	2016 € million
Defined benefit obligation	(461)	(418)
Plan assets	464	422
Surplus	3	4
Experience losses on plan assets:		
Amount	-	(15)
Percentage of the present value of the plan assets	0%	(3.6%)
Actual return less expected return on plan assets:		
Amount	35	62
Percentage of the present value of the plan assets	7.5%	14.7%

Defined contribution scheme

The charge recognised under the MPP was €17 million (2016: €18 million) and is included in "General administrative expenses".

Other long-term employee benefits

The Bank maintains a medical retirement benefit plan 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 was €3 million (2016: €3 million).

29. Related parties

The Bank has the following related parties:

Key management personnel

Key management personnel comprise: members of the Bank's Executive Committee, Managing Directors and the Director of the President's Office.

Salaries and other benefits paid to key management personnel in 2017 amounted to €18 million (2016: €17 million). This comprises salary and employee benefits of €14 million (2016: €13 million) and post-employment benefits of €4 million (2016: €4 million).

In pound sterling terms, the salaries and other benefits paid to key management personnel in 2017 amounted to £16 million (2016: £14 million), comprising salary and employee benefits of £13 million (2016: £11 million) and post-employment benefits of £3 million (2016: £3 million).

Venture capital associates

The Bank has invested in a number of venture capital associates that it accounts for at fair value through profit or loss. At 31 December 2017, according to the 2016[79] audited financial statements (and where these are not available, the most recent unaudited management information) from the investee companies, these venture capital associates had total assets of €29.5 billion (2016: €21.7 billion) and total liabilities of €21.7 billion (2016: €15.4 billion). For the year ended 31 December 2016, these associates had income of €4.3 billion (2015: €4.8 billion) and made €0.5 million profit before tax (2015: €nil net gain or loss before tax).

In addition, as at 31 December 2017, the Bank had outstanding €17 million (2016: €30 million) of financing to these companies on which it had received €1 million (2016: €1 million) of interest income during the year.

There were no venture capital associates deemed material to the Bank at 31 December 2017.

[79] The 2016 financial statements are the most recent available.

Special Funds

Special Funds are established in accordance with Article 18 of the Agreement Establishing the Bank and are administered under the terms of the rules and regulations for each such Special Fund. At 31 December 2017 the Bank administered 18 Special Funds (2016: 17 Funds) with aggregate pledged contributions and associated fees amounting to €2.1 billion (2016: €1.5 billion).

The Bank acts as manager and administrator of the Special Funds for which it receives management and cost recovery fees. In 2017 these fees amounted to €12.6 million (2016: €2.3 million) of which €0.9 million was receivable at 31 December 2017 (2016: €1.1 million).

The Bank pays for guarantees from certain Special Funds in respect of specific exposures arising in its trade finance portfolios for which it paid €0.1 million in 2017 (2016: €0.1 million). In addition, the Bank also benefits from fee-free guarantee arrangements with certain Special Funds for losses which it could potentially incur in its investment activities. The provision of these guarantees qualifies such Special Funds as unconsolidated structured "entities" within the meaning of IFRS 12. The Bank's only exposure to these Special Funds would arise in the period between recognising a guarantee receivable on its balance sheet and the settlement of that receivable.

At 31 December 2017 the Bank had €2.5 million such exposures (2016: €2.9 million) of which €0.2 million was receivable from the SME Local Currency Special Fund for losses written off.

Audit fees payable to the Bank's auditor for the 2017 audits of the Special Funds totalled €0.1 million (2016: €0.1 million).

The financial statements of each Special Fund are approved separately by the Board of Governors at the Bank's Annual Meeting.

Trust Funds

On 10 May 2017 the Board of Directors established the Trust Fund for the West Bank and Gaza and the Multi-Donor Trust Fund for the West Bank and Gaza in accordance with Article 20.1 (vii) of the Agreement Establishing the EBRD. The Trust Funds are governed under the terms of the rules and guidelines for each such Trust Fund.

At 31 December 2017 the total pledged contributions to the Trust Fund for the West Bank and Gaza were €30 million (2016: €nil) and the total pledged contributions to the Multi-Donor Trust Fund for the West Bank and Gaza were €nil (2016: €nil).

The Bank acts as the administrator of both Trust Funds and is entitled to management and cost recovery fees. During 2017 these fees totalled €1 million for the Trust Fund for the West Bank and Gaza, of which €0.1 million was receivable at 31 December 2017.

The financial statements of the Trust Fund in operation are approved separately by the Board of Governors at the Bank's Annual Meeting.

30. Other fund agreements

Cooperation Funds

In addition to the Bank's ordinary operations, the Special Funds programme and the Trust Funds, the Bank administers numerous bilateral and multilateral contribution agreements to provide technical assistance and investment support grants in the existing and potential countries in which it invests. These grants focus primarily on project preparation, project implementation (including goods and works), advisory services and training. The Bank also acts as a fund manager for donor financed grants that can be accessed by other International Finance Institutions. This fund manager function of the Bank exists under the following funds: Eastern Europe Energy Efficiency and Environment Partnership Funds (E5P), European Western Balkans Joint Fund (EWBJF – under Western Balkans Investment Framework) and Northern Dimension Environmental Partnership Fund (non-nuclear).

The resources provided through cooperation contribution agreements are held separately from the ordinary capital resources of the Bank and are subject to external audit.

In 2017 new agreements and replenishments of €432 million (2016: €517 million) were signed with donors. Contributions of €195 million (2016: €278 million) were received, and disbursements of €131 million (2016: €115 million) paid out during the year. At 31 December 2017, the total number of open Cooperation Funds was 204 (2016: 192).

Nuclear Funds

Following a proposal by the G-7 countries for a multilateral programme of action to improve safety in nuclear power plants in the countries in which the Bank invests, 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 8 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 finance selective projects to help with the decommissioning of designated reactors. They also finance measures to facilitate the necessary restructuring, upgrading and modernisation of the energy production, transmission and distribution sectors and improvements in energy efficiency.

In late 1999, the European Council launched the Northern Dimension policy as demonstration of regional cooperation. The Bank was entrusted with setting up a Northern Dimension Environmental Partnership (NDEP), as a multi-donor fund providing grant assistance to address the most pressing environmental challenges in the north-west Russia focusing on radioactive waste. The Board of Directors adopted the Rules of the NDEP Support Fund on 10 January 2002. On 21 May 2003, the European Commission, Russia and a number of donor countries signed a framework facilitating cooperation in the area of safety of spent nuclear fuel and radioactive waste management in Russia, referred to as the "Multilateral Nuclear Environmental Programme in the Russian Federation" (MNEPR). The signing of the MNEPR was a pre-condition for entering into NDEP grant agreements and marked the beginning of operations in the NDEP nuclear safety programme.

In 2013 the European Commission requested the Bank to set up a multilateral fund for financing of the projects dealing with uranium mining legacy in Central Asia. In May 2015, the Bank's Board of Directors approved the Rules of the Environmental Remediation Account and the role of the Bank as fund manager. The Account became operational in 2016.

The table below provides a summary of Nuclear Fund contributions.

	2017 Contributions pledged € million	2017 No. of contributors	2016 Contributions pledged € million	2016 No. of contributors
Nuclear Safety Account	403	17	376	17
Chernobyl Shelter Fund	1,651	28	1,586	28
Ignalina IDSF	778	15	778	15
Kozloduy IDSF	1,044	10	1,002	10
Bohunice IDSF	653	8	653	8
NDEP[80]	353	12	353	12
Environmental Remediation Account	23	2	16	1

The cash balances belonging to each of the funds in the table above are managed by the Bank on their behalf.[81]

Audit fees payable to the Bank's auditor for the 2017 audits of the Cooperation and Nuclear Safety funds amounted to €0.5 million (2016: €0.5 million).

Equity Participation Fund

In 2016 the Bank set up the EBRD Equity Participation Fund LP (EPF) as part of a strategy to attract long-term institutional capital into private sector investments in the EBRD's countries of operations. The EPF is a fixed-term fund (12 years) that gives investors a pre-determined (20 per cent) holding in new EBRD direct equity investments which meet the EPF eligibility criteria. These eligibility criteria ensure that neither the EBRD nor the EPF are able to "cherry-pick" the investments in which the EPF participates. Throughout the life of the direct equity investment the EBRD retains legal ownership and control over the equity investments, albeit that the economic benefits of the participation do not accrue to the Bank. In return for the purchase price the EPF receives from the EBRD an equity return swap (ERS). The ERS is currently held on the EBRD's balance sheet under "Other Liabilities" and as at 31 December 2017 has a total value of €42 million (2016: €nil). In exchange for managing the equity investments the EBRD receives a management fee. Since the EPF's inception a total of €45 million has been invested in eight eligible investments.

31. Events after the reporting period

There have been no material events since the reporting period that would require adjustment to these financial statements.

Since 31 December 2017 observable movements in the value of the Bank's listed equities in 2018 have resulted in a increase of approximately €69 million while movements in the exchange rate of the United States dollar have increased the fair value of the Bank's unlisted equity investments and associated derivatives by approximately €22 million. These gains of €22 million will be recognised in the 2018 financial statements.

At 27 February 2018 there had been no other material events after the reporting period to disclose.

On 27 February 2018 the Board of Directors reviewed the financial statements and authorised them for issue. These financial statements will be submitted for approval to the Annual Meeting of the Board of Governors to be held on 8-10 May 2018.

[80] The NDEP includes a nuclear and non-nuclear programme.

[81] See note 21 on page 67.

32. Restatement

In 2017, the Bank adopted a new accounting policy concerning the timing of recognition of fees charged on undrawn loan commitments. Previously fees charged on undrawn loan commitments were deferred and accounted for as integral to the effective interest rate of the resulting loan. The Bank's new policy is to recognise revenue from these fees in the period in which the loan commitment is not utilised, which is also the period that they are charged. This provides more relevant and reliable information to the users of the Bank's accounts and reflects income earned for the provision of a loan facility that is not utilised.

The impact of this change in policy on the income statement in 2017 was a net increase in profit of €12 million (2016: €7 million), with fee and commission income increasing by €47 million (2016: €48 million) and interest income from Banking loans reducing by €35 million (2016: €41 million).

The cumulative impact of this change in policy on the balance sheet in 2017 was an increase in both loans at amortised cost and retained earnings of €139 million (2016: €127 million; 2015: €120 million).

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 associated disclosures presented in this *Financial Report 2017*. 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 presentation and measurement 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 are revised, as considered necessary, taking account of any related internal audit recommendations – 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 2017. Management's assessment includes the Special Funds and other fund agreements referred to in notes 29 and 30 of the *Financial Report 2017*, and the retirement plans. However, the nature of the assessment is restricted to the controls over the reporting and disclosure of these funds/plans 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 (2013 framework). Based upon this assessment, management asserts that at 31 December 2017 the Bank maintained effective internal controls over its financial reporting as contained in the *Financial Report 2017*.

The Bank's external auditor has provided an audit opinion on the fair presentation of the financial statements presented within the *Financial Report 2017*. 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 82.

Suma Chakrabarti
President

European Bank for Reconstruction and Development
London
27 February 2018

András Simor
Senior Vice President, Chief Financial Officer and Chief Operating Officer

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 2017*, 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 (2013 framework). 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 "reporting" section of the Bank's *Financial Report 2017* 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 (2013 framework).

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
27 February 2018

Independent auditor's report to the Governors of the European Bank for Reconstruction and Development

Report on the audit of the financial statements

Opinion

In our opinion the financial statements present fairly, in all material respects, the financial position of the European Bank for Reconstruction and Development (the Bank) at 31 December 2017 and its financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

We have audited the financial statements of the Bank, 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 statement of accounting policies
- the risk management disclosures
- the related notes 1 to 32.

The financial reporting framework that has been applied in their preparation is applicable law and IFRS as issued by the IASB.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (ISAs) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the Bank in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) together with the ethical requirements that are relevant to our audit of the financial statements in the United Kingdom, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion. We confirm that the non-audit services prohibited by the Financial Reporting Council's Ethical Standard were not provided to the Bank.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • valuation of illiquid equity investments and associated derivatives • loan impairment and provisioning: portfolio and specific provisions • restatement due to a change in accounting policy for commitment fees. Within this report, any new key audit matters are identified with ^ and any key audit matters which are the same as the prior year identified with > .
Materiality	The materiality that we used in the current year was €115 million which was determined on the basis of 0.75 per cent of shareholders' equity (before restatement) of €15.4 billion as disclosed in the balance sheet and statement of changes in equity.
Scoping	Our audit was performed on the Bank's legal entity. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.
Significant changes in our approach	We have identified the restatement due to a change in accounting policy for commitment fees as a new key audit matter for this year. There are no other significant changes in our approach.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Valuation of illiquid equity investments and associated derivatives	
Key audit matter description >	The valuation of illiquid equities (December 2017: €3.3 billion, December 2016: €3.5 billion) and associated level 3 derivatives (December 2017: €378 million, December 2016: €517 million) is a key audit matter given the large size of the portfolio and the inherent subjectivity when determining fair values. In general there are a lack of comparable market transactions in the Bank's countries of operations leading to difficulties in deriving fair values for illiquid equity investments. Additionally, the Bank enters into option transactions in order to facilitate an exit route for certain equity investments. Valuation of the associated derivatives is complex as they relate to subjective variables such as the valuation of the underlying equity and the time value to the option exercise date. The fair value of both the illiquid equity investments and associated derivatives can therefore fall within a relatively wide valuation range. Due to the high level of judgements involved, we have determined that there was a potential for fraud through possible manipulation of this balance. Management have assessed the sensitivity of the portfolio by considering reasonably possible alternative assumptions (such as multiples) in the individual equity valuations as disclosed within Risk Management Note F on page 57 in the financial statements. The relevant accounting policy is disclosed in Note B on page 20, and further details in Notes 5, 14 and 17 to the financial statements.

How the scope of our audit responded to the risk	We completed the following procedures in relation to the valuation of illiquid equity investments and associated derivatives:
	
	• We tested management controls in place over the valuation process for illiquid equity investments and associated derivatives. This involved gaining an understanding of the Bank's valuation methodology and the processes and procedures to ensure this methodology is consistently applied over the portfolio with appropriate management review and challenge.
	• We tested a sample of illiquid equity investments and associated derivatives to assess the appropriateness of the valuations applied by the Bank. Our work has involved testing and challenging the inputs and assumptions used in the methodologies adopted. This has included:
	    o assessing the appropriateness of the methodology used – the Bank adopts a number of methodologies to estimate fair value including the use of earnings multiples, Net Asset Values or discounted cash flows and we have assessed the appropriateness of the methodology choice made for each investment taking into account the nature of the investment being valued.
	    o assessing the appropriateness of inputs and assumptions – within each methodology, there are a number of inputs and assumptions. We have tested factual inputs (for example earnings, comparable company multiples) to source information and assessed the appropriateness of any assumptions (for example the choice of comparable companies, the level of liquidity discounts) applied to arrive at the final valuation.
	• We have performed retrospective testing at the portfolio level to consider the reasonableness of the Bank's valuations in light of exit proceeds received during the year.
	• We considered the frequency of historic trading of listed equities and assessed whether these investments had been appropriately classified as liquid or illiquid.
	• We agreed a sample of equity investments to shareholding certificates and custody statements.
	• We reviewed publicly available information in relation to the Bank as well as Bank Committee minutes for indications of exits or disbursements around year end.

Key observations	We conclude that the valuation of illiquid equities and associated derivatives is appropriate and towards the middle of the acceptable range of possible outcomes.

Loan impairment and provisioning: portfolio and specific provisions	
Key audit matter description >	There are significant provisions recognised by the Bank with respect to loans. Provisions for loan impairment are split between incurred but not recognised (IBNR) (referred to as "general portfolio provisions" by the Bank) (December 2017: €248 million, December 2016: €279 million) and specific provisions (December 2017: €602 million, December 16: €765 million). With regards to portfolio provisions, management use a model to calculate IBNR losses based on a Board approved provisioning policy. This provisioning model uses inputs such as probability of default (PD), loss given default (LGD) and emergence period that involve considerable management judgement due to the often bespoke nature of the underlying loans. As a result, we identified a key risk of material misstatement over the IBNR provisioning model. Individually assessed specific provisions are based on the net present value of expected cash flows to be received on a loan once it has been classified as impaired by the Bank. In determining the level of specific provisions there are judgements and estimates made by management which involve a level of subjectivity and as a consequence we identify this area as a key risk of material misstatement in the financial statements. These include matters such as the valuation of illiquid collateral as well as the identification and assessment of potential indicators of impairment. Management disclose information about credit risk in section A of risk management on page 28, as well as the relevant accounting estimates for portfolio and specific provisions in section C of accounting policies on pages 25 and 26, and further details in notes 10 and 15 to the financial statements.
How the scope of our audit responded to the risk	In order to challenge the IBNR provision we: • assessed the model for compliance with IFRS • assessed the sensitivity of the model to reasonable levels of change in key variables and considered whether any more reliable estimate might result from changing the variables accordingly • tested back to relevant internal and external data that the correct PD and LGD inputs had been applied for a sample of loans included within the provisioning model • tested the completeness of the loan population included within the model by reconciling to the ledger • reperformed the model to check its mathematical accuracy. In order to challenge the specific provision balance we: • examined the controls in place over the credit assessment process for banking loans to ensure they had been designed and implemented correctly and had operated effectively throughout the year • reviewed a sample of impaired loans to determine whether a loss event could be identified for these loans and to assess the appropriateness of the specific level of provisions applied. We reviewed both the assumptions used in relation to cash flows and the input data supporting the provision calculations • considered the completeness of the specifically impaired loans population by reviewing a sample of unimpaired loans to determine whether a loss event could be identified for these loans which would require an impairment • reviewed whether there were any new impairments in January 2018 to challenge whether the impairment assessment is reflective of loss events that should have been assessed as a 2017 provision.
Key observations	Overall, we concluded that the level of provisioning is appropriate and is towards the more prudent end of our acceptable range of possible outcomes.

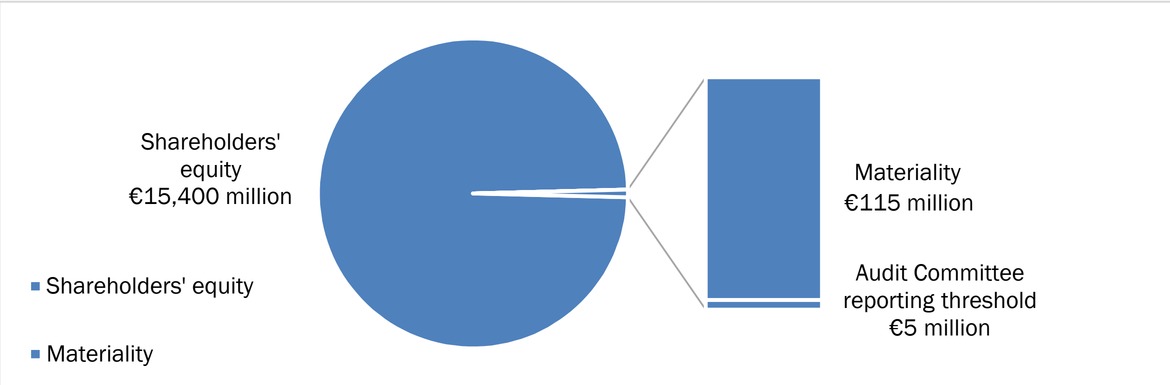
Restatement due to a change in accounting policy for commitment fees	
Key audit matter description ^	Historically the Bank's accounting policy has been to include commitment fees related to loan facilities within the effective interest rate (EIR) calculation and spread these over the period determined by the calculation. The Bank has made a decision to change its accounting policy in relation to commitment fees with these recognised as earned over the commitment fee period. The Bank has chosen to to make this change as it believes that the proposed treatment better reflects the underlying circumstances. The change in policy has led to an increase in profit of €12 million in 2017. Corresponding profits in 2016 have been restated and have been increased by €7 million. Opening balance sheet reserves of €127 million as at 31 December 2016 have been restated with the majority of the change (€120 million) relating to reserves as at 31 December 2015 reflecting the fact that the majority of this change relates to fees received prior to this date. Given the material impact of this change in accounting policy, it has been deemed to be a key audit matter. Management disclose information about the restatement in note 32 on page 80.
How the scope of our audit responded to the risk	Under the relevant accounting guidance in IAS 18, the treatment of such fees depends on specific facts and circumstances. We have reviewed the EBRD's transactions and change in policy in line with this accounting guidance. We audited the adjustments arising from the restatement by recalculating the income to be recognised for a sample of loans based on the contractual terms of each facility.
Key observations	Based on the analysis above we consider the revised treatment is appropriate and hence comparative balances have been restated in accordance with IAS 8. No issues were identified from our substantive procedures.

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	€115 million (2016: €109 million)
Basis for determining materiality	The materiality was determined on the basis of 0.75 per cent (2016: 0.75 per cent) of shareholders' equity (before restatement) of €15.4 billion (2016: €14.6 billion) as disclosed in the balance sheet and statement of changes in equity.
Rationale for the benchmark applied	Materiality has been based on shareholder equity given our assessment of this being the most stable metric, and the most applicable to the operation of the Bank.



We agreed with the Audit Committee that we would report to the committee all audit differences in excess of €5 million (2016: €5 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Our audit was scoped by obtaining an understanding of the Bank and its environment, including internal control, and assessing the risks of material misstatement. Our audit was performed on the Bank legal entity given there were no material consolidated entities as at 31 December 2017. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

Other information

The President is responsible for the other information. The other information comprises the Highlights, Financial Results and Additional Reporting and Disclosures sections of the *Financial Report* for the year ended 31 December 2017. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in respect of these matters.

Responsibilities of the President for the financial statements

The President is responsible for the preparation and fair presentation of the financial statements in accordance with IFRS as issued by the IASB, 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.

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

The President is also responsible for overseeing the Bank's financial reporting process.

Auditor's responsibilities for the audit of the financial statements

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

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

- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- obtain an understanding of internal control relevant to the audit 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.
- evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the President.
- conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained to the date of our auditor's report. However, future events or conditions may cause the Bank to cease operating as a going concern.
- evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

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

Report on other legal and regulatory requirements

Matters on which we are required to report by exception

We are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit
- proper accounting records have not been kept.

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

Audit tenure

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.

Following the recommendation of the audit committee, we were appointed by the President on 31 May 2011 to audit the financial statements for the year ending 31 December 2011 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is seven years, covering the years ending 31 December 2011 to 31 December 2017.

Consistency of the audit report with the additional report to the Audit Committee

Our audit opinion is consistent with the additional report to the Audit Committee we are required to provide in accordance with ISAs.

Alan Chaudhuri

For and on behalf of Deloitte LLP

London, United Kingdom
27 February 2018

Notes

Notes

Notes

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Note: Terms and names used in this report to refer to geographical or other territories, political and economic groupings and units, do not constitute and should not be construed as constituting an express or implied position, endorsement, acceptance or expression of opinion by the European Bank for Reconstruction and Development or its members concerning the status of any country, territory, grouping and unit, or delimitation of its borders, or sovereignty.

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