REPORT OF THE BOARD OF DIRECTORS TO THE BOARD OF GOVERNORS

STRATEGY IMPLEMENTATION PLAN 2023–2025

The Strategy Implementation Plan (SIP) 2023-25 supports Ukraine and maintains a steady course to deliver the Bank's strategic goals in troubled times.

After two years of debilitating impacts from the Covid-19 pandemic a recovery was underway in 2022 when Russia's unwarranted and unprovoked invasion of Ukraine in February came as a profound shock to the world. The ramifications for many EBRD countries of operations were enormous and much of the region was thrown into crisis once again.

Not only was the war devastating for Ukraine, a major EBRD country of operations for over 30 years, but it also impacted neighbouring countries significantly as trade became severely disrupted and huge swathes of displaced Ukrainians – mostly women, children and the elderly – crossed its borders and sought refuge in the west. EBRD countries of operations such as Poland and the Czech Republic hosted large numbers of refugees as did for example, as a proportion of its population, Moldova.

The Bank took swift action in response to these events. A €2 billion Resilience and Livelihoods Framework for Ukraine and countries affected by the war was quickly agreed and its first operations began in April. Since then, and confirmed in SIP 2023-25, the EBRD has committed to invest up to €1.5 billion annually with donor help over two years, amounting to up to €3 billion over 2022 and 2023. Over €1 billion has already been committed in 2022 and disbursements are accelerating.

There were costs for the Bank too in taking actions to protect the welfare of its staff caught up by the war and in reconfiguring resources to manage the new situation.

The war is continuing, with no end in sight. This has meant a further need to support Ukraine and affected clients in the face of their economic difficulties. The Bank now expects Ukraine's economy to shrink by 30 per cent in 2022 and in the most affected regions - CEB, SEE and EEC - growth in 2023 is expected to be some 2 to 3 percentage points lower compared with 2022.

Among the consequences of the war was a surge in energy and food prices. This prompted a renewed concern over food and energy security in EBRD regions and has been – and will continue to be - a focus of the Bank's response, with significant liquidity support already provided to Naftogaz and Ukrenergo in Ukraine and to several agribusinesses for example.

SIP 2023-25 proposes that the Bank continues to invest at close to record levels in 2023. Given the uncertainties surrounding Ukraine and the economic situation an ABI range of €10.5 billion to €11.5 billion is projected for 2023, with between 395 and 435 projects expected to be signed. The Bank also aims to mobilise €1.4 billion of private co-finance in 2023, an ambitious target in view of tightening financial conditions and an unfavourable investment climate outlook.

Notwithstanding the critical importance of supporting Ukraine, the EBRD continues to be at the forefront of financial institutions willing and able to devote significant resources to tackling climate change and adaptation, and has a unique focus on the private sector. The UN Secretary General has said of climate change, following publication of the latest UNEP Emissions Gap Report, "It is the defining issue of our time ... [its] impact … is already devastating". As Chair of the Climate Heads' Group of MDBs, the EBRD played a prominent role at COP27 in Egypt in November.

After finalising procedures to align EBRD operations with the goals of the Paris Agreement further important actions are planned for 2023, notably on scaling up policy engagements with countries of operations to create low carbon and climate-resilient pathways, increased application of digital solutions, further 'green' mobilisation and address demand for climate adaptation and nature finance.

In 2021 the SCF goal for the EBRD to become a majority green bank by 2025 was achieved. However, the large resources expected to be devoted to supporting clients affected by the war on Ukraine, especially for energy security and publicly-owned companies, will likely restrict the Bank' ability to achieve the 50 per cent GET target in 2023, as it has in 2022. While the Bank remains steadfast in seeking to be a majority green bank this prospect looks beyond reach in 2023 so the GET target has been kept at 45 per cent, the 2022 level, which itself implies EBRD green finance of some €5 billion this year. The private sector share objective is maintained at 75 per cent of ABI.

SIP 2023-25 also ensures the rollout of the Equality of Opportunity and Gender strategies continues at pace, though resource pressures limit the development of new products and approaches. Gender-tagged operations are already increasing in number and the scorecard target for 2023 has been raised to 30 per cent of operations (from 25 per cent), building progressively towards the 40 per cent aim advocated in the SCF.

The SCF goal of improving the Bank's contribution to the digital transition has been enhanced by the introduction of a 'digital hub' to coordinate and encourage Bank activities in the digital space in 2023. In parallel, internal strengthening of digital capabilities within the Bank will lend credibility to the Bank's external efforts on the digital transition agenda.

While implementing core SCF priorities, the Bank remains focused on helping the least advanced countries. The corporate scorecard target of 48 per cent of ABI allocated to ETCs, the Western Balkans and SEMED is retained for 2023 although reaching it, given the effort on Ukraine, will be very difficult to achieve. This is especially the case since the Bank has stopped transactions in Belarus (an ETC country) and with business in Lebanon and Turkmenistan heavily constrained. Although Algeria is expected to become a SEMED country of operations in 2023, and provision in SIP 2023-25 is made for the setting up of a local office, it is unlikely to contribute much to this target for some while.

The Bank's business model makes good use of donor funds. Indeed, support for Ukraine and other countries affected by the war could not have been achieved without it. Very generous contributions and pledges by the Bank's donor community have already reached nearly €1.4 billion, including an unprecedented contribution of US $500 million from the United States. On a wider front, additional indicative donor funds mobilised for future use in 2023 and beyond are at high levels, with donor fees also able to support new fee-funded staff positions to help with the deployment of donor funds.

SIP 2023-25 provides additional resources (a gross investment of £2.1 million and 22 FTEs) for the Bank's efforts on the war on Ukraine in 2023. It does so in a context that is both important – the Bank's mission to help countries become sustainable market democracies has never been more relevant than today – but difficult given the exceptional economic backdrop of high inflation and rapidly rising costs.

The war has fuelled inflation in all countries. 'Bank-wide' inflation (a measure including ROs) reached 10.3 per cent in August and UK CPI inflation of 9.9 per cent was recorded for that month. These are the highest figures for many decades and around three times higher than a year ago. Rising costs for a good part of the Bank's budget are unavoidable, such as inflation-linked contracts, licence fees and so on. The problem is compounded by the fact that well over 70 per cent of salaries paid to RO staff are linked to the US dollar, which has strengthened considerably against sterling in the course of 2022.

Against this backdrop of intense cost pressures, management has sought to maximise efficiency savings and reallocate resources to new priorities in seeking a budget that maintains the Bank's financial sustainability. The proposed administrative budget request of a 9.3 per cent increase is below inflation, and involves a significant real reduction in the salary budget.

The considerable resources allocated in SIP 2022-24 have been deployed in 2022 to core SCF front-line activities above. While SIP 2023-25 adds to this total in a small way, mostly on GET, this year there is an enhanced focus on reinforcing delivery capacity through resources devoted to delivery-enabling 'back office' activities. Some of these allocations, such as on corporate recovery, are simply a corollary of the war on Ukraine, while others, like sanctions compliance, climate risk assessments or ensuring that human rights are respected, follow the general trend for stronger regulation and accountability. However, as the portfolio grows and with it greater dependence on items like donor funds and associated reporting requirements, the complexities of managing the Bank's business increases. As do operational risks. SIP 2023-25 thus takes steps to address some of these issues with a gross allocation in 2023 of 37 FTEs and £5.2 million to reinforcing delivery (the great majority of which is financed by efficiencies and reallocations).

The major investment under the MYIP also helps improve the Bank's delivery capability. After some delays linked to Covid-19 and supply chain disruptions, the results of MYIP investments so far are beginning to be felt, with for example the risk profile of technology in the Bank expected to be materially reduced by end-2022 (from Very High to High/Medium). Improvements are being made on multiple fronts with further enhancements to Monarch, connectivity and networks in ROs, automation and preparations for the end of SAP among them with many components to be implemented in 2023. MYIP capex for Phase 3 is confirmed at £62.9 million, with up to £16.8 million invested in 2023. Taken together with Phases 1 and 2, MYIP investment will total £57.5 million next year.

Projections based on planned business volumes and related financial assumptions show that the EBRD's finances are sustainable over the SIP period. Members' equity after income allocations is expected to grow from next year onwards, capital utilisation should remain broadly stable and the Bank's financial metrics remain above key rating agency thresholds. Whilst stress test results are expected to remain within Financial Loss Tolerance Thresholds (FLTT) based on the Bank's internal capital policies, a number of rating agency ratios are expected to be breached in the Severe stress test. Under such a scenario, it is expected that the Bank's triple-A rating would come under significant pressure. This is the highest level of risk that the Bank has accepted in its business plan since the introduction of formal stress testing of the SIP.

A substantial full year loss expected in 2022 which, while smaller than net profits achieved in 2021, means that the three-year rolling average rate for return on required capital (RoRC) is projected to fall below the long run average minimum return of 3.5 per cent set in the corporate scorecard. Although annual returns are projected to be well above 3.5 per cent from 2023 on (7.9 per cent is projected for 2023 for example) the three-year rolling return on required capital is only expected to exceed the minimum level by 2025 when the deeply negative return in 2022 is no longer included in the calculations. The debt return on required capital, which focuses on the more stable part of Bank income, is set at a minimum of 12 per cent for 2023.

SCF resource control parameters are projected to be met throughout SIP 2023-25. After a sharp increase in the cost to debt income ratio in 2022 to 60.4 per cent, predominately driven by unrealised losses from the loan portfolio measured at fair value to counterparts with exposure to Ukraine, Belarus and Russia, the ratio is expected to increase by 7.1 percentage points by end-2025, reflecting inflationary pressures and MYIP expenditures. It nonetheless remains below the 70 per cent SCF control parameter limit. The other SCF control parameter, the five-year average of the staff cost to total cost ratio, is projected to remain stable at around 68 per cent and below the 70 per cent threshold.

After large Borrowing Programme in 2021 and 2022, planned activity is lower in 2023, with a proposed Borrowing Programme of up to €10 billion, of which €8 billion is expected to be used. Liquidity ratios maintain a comfortable buffer above required minimum levels, meeting the relevant stress tests, and net cash requirements are well covered.

In preparing SIP 2023-25 management have addressed resource effectiveness holistically and sought to find ways of doing things better. This has been helped by the introduction of a new Transformation Office. Even after initial discussions, some 99 headcount positions at a total cost of £10.8 million (including non-staff) were judged to be needed to support the Bank's business in 2023. An exhaustive review process (without the advantages of the mobility enhancement programme) resulted in two-thirds of the identified needs, or 66 headcount positions at a total cost of £6.6 million, being met through staff and non-staff efficiencies and reallocations.

The Budget Proposal of a Core Administrative Expense Budget of £448.2 million for 2023 represents an increase of 9.3 per cent, and is below Bank-wide and UK CPI inflation. Non-discretionary budget increases arising from inflation and carryover impacts, the weakness of sterling and costs associated with Ukraine account for the largest component of the change (4.3 per cent) followed by increases in staff costs (3.2 per cent) associated with proposals on compensation and benefits. A one-off alignment of the compensation budget to a calendar year basis, which increases the transparency of the annual budget process, accounts for a further small part of the increase (1.0 per cent), £10.8 million of overall resource needs are reduced by £6.6 million of savings from efficiencies and reallocations, leaving a net resource request of £4.2 million (1.0 per cent) for additional support for business priorities. In addition, the Bank will undertake additional efficiency measures of £1.0 million (-0.3 per cent) linked to staff and non-staff cost structures, underscoring the commitment to ongoing efficiency gains.

The new request is a culmination of a very disciplined approach and imposes tight constraints on resources needed to deliver SCF ambitions in a complex and challenging operating environment.

The Total Administrative Expense Budget for 2023 is £482.6 million, and includes £34.4 million for extraordinary items (LIBOR transition, £2.7 million, and MYIP Phases 1, 2 and 3 opex and depreciation, £22.9 million, £8.5 million and £0.2 million respectively).
SIP 2023-25 is designed to deliver the Bank's operational priorities within a responsible financial envelope that protects the EBRD's financial standing. It is underpinned by a concerted management effort to use resources efficiently and effectively. This SIP ensures the Bank will be able to continue to support Ukraine and other countries affected by the war and maintain a steady course to deliver the Bank's strategic priorities, despite potential turbulence ahead.

ANNEX 1:
PROJECTED TOTAL ADMINISTRATIVE EXPENSE BUDGET 2023-2025

Projected Total Administrative Expense Budget 2023-25 (£ million)

	2022 Budget	2023 Budget	2024 Projection	2025 Projection
Core Administrative Expenses, GBP	**410.1**	**448.2**	**470.6**	**494.1**
Extraordinary Budget Items GBP	**22.1**	**34.4**	**35.9**	**48.2**
LIBOR Transition	5.3	2.7	-	-
MYIP (opex and depreciation) - Phase 1	11.3	22.9	23.5	23.5
MYIP (opex and depreciation) - Phase 2	5.5	8.5	9.2	14.3
MYIP (opex and depreciation) - Phase 3	-	0.2	3.2	10.5
Total Administrative Expense Budget, GBP	**432.2**	**482.6**	**506.6**	**542.4**
GBP/EUR rate	1.17	1.14	1.16	1.16
Core Administrative Expenses, EUR	**479.9**	**510.9**	**545.9**	**573.2**
Extraordinary Budget Items EUR	**25.9**	**39.2**	**41.7**	**56.0**
LIBOR Transition	6.2	3.1	-	-
MYIP (opex and depreciation) - Phase 1	13.2	26.1	27.3	27.3
MYIP (opex and depreciation) - Phase 2	6.4	9.7	10.7	16.5
MYIP (opex and depreciation) - Phase 3	-	0.3	3.7	12.1
Total Administrative Expense Budget, EUR	**505.7**	**550.2**	**587.6**	**629.2**

ANNEX 2: CORPORATE SCORECARD 2023

	2023	30/09/2022		2022	2021	
	BP and Budget	Actual	Plan rate	BP and Budget	Actual	Plan rate
TRANSITION IMPACT						
Expected Transition Impact	63 – 69	67		63 – 69	67.7	
Portfolio Transition Impact	Min 68	73.8		Min 68	72.8	
Transition Qualities						
Competitive, innovative economies	CPA*	CPA*		CPA*	Good	
Well-governed economies and firms	CPA*	CPA*		CPA*	Good	
Environmentally sustainable, green economies	CPA*	CPA*		CPA*	Very Good	
Inclusive, gender-equal economies	CPA*	CPA*		CPA*	Very Good	
Resilient economies and firms	CPA*	CPA*		CPA*	Good	
Well-integrated, connected markets	CPA*	CPA*		CPA*	Good	
Green Economy Transition (% ABI)	45%	46%		45%	51%	
Gender-tagged Operations (% No. of ops)	min 30%	37%		min 25%	35%	
OPERATIONAL PERFORMANCE						
Number of operations	395 – 435	276		395 – 435	413	
Annual Bank investment (€ billion)	10.5-11.5	7.7	7.3	10.0-10.5	10.4	10.4
Annual mobilised investment (€ billion)	Min 1.4	1.0		Min 1.4	1.8	
Private Sector Share (% ABI)	Min 75%	76%		Min 75%	76%	
Disbursements (€ billion)	7.0 – 8.0	5.9	5.7	7.0 – 8.0	7.3	7.3
Activity in Early Transition Countries, Western Balkans and SEMED (% ABI)	Min 48%	42%		Min 48%	38%	
FINANCIAL PERFORMANCE						
Return on Required Capital (3 year rolling average)	Min 3.5%	3.0%		3.50%	11.90%	
Debt Return on Required Capital before Costs	Min 12%	-8.2%		12.00%	21.30%	
INSTITUTIONAL PERFORMANCE						
Productivity (number of operations based)	1.3-1.5	Annual		1.4 – 1.6	1.6	-
Cost to Debt Income Ratio (12 months rolling avg)	Max 63%	58.5%		Max 60%	46.9%	
Staff Engagement Ratio	tracked	Annual		tracked	7.3	
Operational Risk Assessment	tracked	Annual		tracked	n/a	
RESOURCE FRAMEWORK						
EXPENDITURE						
Administrative Expense Budget						
Euro (million)	510.9	347.0		479.9	439.9	
Pound Sterling (million)	448.2	296.6		410.1	394.1	

*Composite Performance Assessment