DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

REPORT OF THE BOARD OF DIRECTORS TO THE BOARD OF GOVERNORS ON THE GEOGRAPHIC EXPANSION OF THE BANK'S REGION OF OPERATIONS TO THE SOUTHERN AND EASTERN MEDITERRANEAN

As approved by the Board of Directors at their meeting of 26/27 July 2011

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EXECUTIVE SUMMARY

At the Bank's Annual Meeting in Astana on 20-21 May 2011 the Board of Governors considered the historic changes occurring in North Africa and the Middle East, Egypt's request to become a recipient country and Morocco's strong interest in becoming a recipient country.

The Board of Governors asked the Board of Directors to make a recommendation to them by 31 July 2011 on an amendment of Article 1 of the Agreement Establishing the Bank providing for an appropriate extension to the geographic scope of the Bank's mandate and to consider also further steps to allow the Bank's operations to start as early as possible in potential recipient countries. Underpinning this request was the belief that the Bank's experience with democratic and market orientated transition could be drawn on by the international community to support actively the historic changes in this region.

A draft Report of the Board of Directors to the Board of Governors responding to this request is attached for consideration. It proposes three Resolutions: amending Article 1 of the Agreement Establishing the Bank to extend the geographic scope of the Bank's operations to the countries of the Southern and Eastern Mediterranean, amending Article 18 of the Agreement Establishing the Bank to allow for the use of Special Funds in potential recipient countries, confirming the Board of Directors' interpretation of the Agreement Establishing the Bank to allow for the use of cooperation funds in prospective recipient countries and making an initial net income allocation of EUR 20 million to those cooperation funds.

REPORT OF THE BOARD OF DIRECTOR TO THE BOARD OF GOVERNORS

GEOGRAPHIC EXPANSION OF THE BANK'S REGION OF OPERATIONS TO THE SOUTHERN AND EASTERN MEDITERRANEAN

1. INTRODUCTION

1.1 Background

The Arab world is witnessing remarkable change. In many countries, citizens are challenging authorities, calling for democracy, accountability, fairness and respect. Their complaints are also rooted in lasting economic hardship and the lack of jobs, especially for the young. Countries of the region differ greatly, and so does the response to this challenge, ranging from democratic revolutions in Tunisia and Egypt, to reforms in Jordan and Morocco and severe violence in some other countries.

The aspirations of the people of the region deserve the international community's wholehearted support. While they will shape their own destinies they can benefit from international expertise, funding and advice. Several international institutions are already active in the region and EBRD has been asked to contribute to this common effort. Egypt and Morocco, both founding Members of the EBRD, have requested to become recipient countries of the Bank. More recently, Tunisia has applied for membership with a view to subsequently requesting recipient status. A separate Board of Directors' Report deals with Tunisia's application.[1]

1.2 Board of Governors' Resolution No. 134

At the Annual Meeting in Astana (20-21 May 2011), the Board of Governors approved Resolution No. 134 asking the Board of Directors to complete expeditiously its consideration of Egypt's request to become a recipient country. The Board of Directors was also asked to make, on or before 31 July, recommendations to the Board of Governors in furtherance of the following objectives:

- an amendment of Article 1 of the Agreement Establishing the Bank (**AEB**) providing for an appropriate regional extension to the geographic scope of the EBRD's mandate together with an appropriate mechanism to grant recipient country status to Member countries within such extended region, paying due regard to the political and economic principles of Article 1 AEB; and

- possible further steps to allow the Bank's operations to start as early as possible in prospective recipient countries of the extended region.

[1] A possible extension of the geographic scope of the Bank's operations received support from the European Council of Heads of State on March 25th and from the G8 leaders' meeting in Deauville on May 26-27.

In addition Resolution No. 134 underlined that such an extension of the Bank's mandate must:

- be achieved without requiring additional capital contributions,
- not compromise the agreed scope and impact of the Bank's operations in the existing recipient countries, and
- be fully coordinated with international financial institutions (**IFIs**) active in the region.

1.3 Resolutions recommended for adoption

The Board of Directors has responded to Resolution No. 134 by considering a detailed Issues Paper on implications of a possible extension of the Bank's geographical mandate (SGS11-162) which was discussed at a one day retreat on 30 June 2011. The Board of Directors has also considered, alongside this report, a Management proposal for cooperation funds for member countries of the extended region (BDS11-176), and on 14 July 2011 held an information session on the implications of an extension of the Bank's geographic remit for the Bank's capital (SGS11-200 (Addendum 1)).

The Board of Directors has now completed its work programme in response to Resolution No. 134 and recommends for adoption by the Board of Governors Resolutions Nos 137, 138 and 139. They would, respectively:

- amend Article 1 AEB to extend the geographic scope of the Bank's operations to the countries of the Southern and Eastern Mediterranean;
- amend Article 18 AEB to allow for the use of Special Funds in potential recipient countries; and
- provide confirmation of the Board of Directors' interpretation of the AEB (adopted on 26 July 2011) on the use of cooperation funds outside the current region of EBRD operations and make a net income allocation to such funds.

These draft resolutions are set out in Annexes 1 to 3 and discussed in Sections 3 to 5. The rest of this report sets out the considerations that have informed the Board of Directors' decisions and recommendations.

1.4 Orientations

Expectations of rapid democratic and material progress are high among the populations of the emerging Arab democracies. Indeed the Bank itself faces high expectations, having been given considerable prominence as part of the collective international response to the "Arab spring". At the same time, a recurring theme at the Bank's Annual Meeting in Astana was the need for the Bank to balance continuity in its mission with a readiness to address the new challenges it will face. This goes to the heart of the Bank's mandate and identity.

While the Bank's strategic directions have been firmly set in the CRR4, the Board of Directors has examined a set of orientations for how the Bank might best combine continuity with a fresh approach. These include:

- As noted in the Preamble to the AEB, the Bank was conceived as an institution "European in its basic character" – while "broadly international in its membership". Its work supports a region that is geographically contiguous and that has developed mutual dependence and shared interests.

- The Bank supports economic transition, informed in part by the understanding, based on its experience, that well-functioning market economies are inclusive as well as competitive. They create jobs, including for the youth, are supported by institutions that ensure fairness, efficiency and transparency, and have corporate governance and behaviours that promote social cohesion.

- The Bank has an effective business model that it can use to address new challenges, combining risk-taking, technical cooperation, business advisory and policy dialogue with on-the-ground implementation capacity. The Bank is owned by recipient and non-recipient countries, ensuring alignment of interests, and it operates in close partnership with other multilateral development banks (MDBs), regional partners and donors.

- The Bank is a "force for transition" not only through projects but through engagement with society, aiming to transfer and adapt the political and economic transition experience from Eastern Europe to this new region. As such, its credibility as an agent of change depends on the careful and continuous assessment of political and economic developments and of the Bank's role against the standards of Article 1 AEB, for countries both "at entry" and subsequently.

- The potential geographic extension of the Bank's mandate does not detract from its strategic commitment to its existing region of operations, with specific organisational and operational steps taken to ensure there is no drain on management, resources and staff. Special care is taken to set targets for the smaller current countries of operations. A geographic extension may lead to an increase in the size of the Bank’s membership, which would be done in accordance with the relevant provisions of the AEB.

1.5 Resolution No. 134 guidance

As noted above Resolution No. 134 set specific parameters for any extension of the Bank's geographical mandate. These are considered in turn below:

- ***Operational and capital capacity for the new region:*** The Board of Directors has examined the capital capacity of the Bank to increase its operational activity. The Bank is estimated to be able to sustain over the medium term an additional level of annual business volume of up to EUR 2.5 billion over and above the operational objectives set out in CRR4. Given this level of additional activity, the Bank will be able to stay within its statutory and economic capital thresholds during the CRR4 period and in the period beyond 2015 without requiring any additional capital. These prudential policy thresholds help to underpin the Bank's 'triple-A' credit rating, which remains a vital prerequisite in any examination of the Bank's capital capacity. In this assessment, Directors have taken note that:

- The CRR4 decision continues to underpin a level of operations in the existing countries of operations within an envelope of EUR 8.5-9 billion.
- There would be a gradual build up of the Bank's operations in the new region.
- The projections are based on rolling forward the prudent operational and financial assumptions contained in CRR4.
- The capital impact of operations in the new region would primarily be towards the end of the CRR4 period, thereby utilising the headroom that was projected in CRR4 and also reflecting additional headroom resulting from the Bank's financial and operational performance since the preparation of CRR4.
- There is the potential for additional operational flexibility through portfolio management and additional profits generated by the Bank. On the same basis, there are also downside risks.

Directors recognise that while the assessment of the potential additional operational capacity that can be sustained within the Bank's capital adequacy limits is based on prudent assumptions, the projections should be regarded as illustrative given uncertainties in the medium term and the necessity to model anticipated outcomes well beyond 2015. These illustrative projections are presented in Annex 5.

- ***CRR4 commitments:*** Directors recall that business plans and CRR4 commitments remain fully valid. The Bank's performance in the first half of 2011 underscores this commitment, having exceeded previous record levels for both project numbers and business volume. Performance has been particularly strong in the early transition countries, continuing the trajectory of recent years.

  The Bank's performance is anchored in the organizational decisions that have been taken in the context of the CRR4 and that will remain firmly in place. In order to ensure that there is no diversion of staff and resources and to protect the interests of existing recipient countries going forward, the Board of Directors has, at its session of 26 July, approved a Supplementary Budget as well as an increase in headcount. These additional resources will be dedicated to the preparatory activities in the new region and will be organisationally segregated from the existing operations of the Bank.

  Directors also recall that graduation remains a fundamental principle for the Bank, which was reiterated as part of the CRR4. The EU-7 countries were firmly on the path to graduation during the CRR3 period until the global financial crisis hit, threatening to set back the transition process, revealing the fragility of some past achievements and sharply increasing demand for EBRD finance in the form of crisis response. This has delayed the process of graduation but has not changed the Bank's Policy and strategic orientation. On the assumption that global market conditions improve, financial flows return thereby reducing the Bank's additionality, the region recovers in a sustainable way and the threat to transition recedes, the EU-7 countries would be expected to graduate during the CRR4 period, taking into consideration each country's specific circumstances.

The Bank will prepare a strategic, comprehensive approach to post-graduation that is consistent with its mandate. This will include an approach to business development and opportunities for cross-border investment, trade, cooperation and knowledge sharing. The transition experience of the graduating countries will be of special value to the "new" transition economies of the Middle East and North Africa, and the Bank would therefore seek to promote such links between both regions, in a non-discriminatory manner.

- ***Cooperation with other IFIs:*** The international response to the Arab spring has helped lift cooperation among IFIs to a new level and the Bank has been closely involved in this process. Partly based on the proactive engagement of the Bank, and partly as a result of the emerging framework of the Deauville Partnership, there is concrete progress on three levels:

    - MDBs formulated a joint action plan for the MENA region ahead of the Deauville G8 meeting. This action plan is being refined and broadened, with the intention to establish a monitoring framework and with the inclusion of regional institutions in the dialogue.

    - At the bilateral level, the Bank is working to establish cooperation frameworks with the African Development Bank and the Islamic Development Bank, and has agreed with the EIB to review the existing Memorandum of Understanding for any need to adjust it to the new circumstances.

    - At the operational level, teams have been in close contact with the field staff of the other IFIs and have at this point identified joint initiatives in five areas in which the Bank could play an active role even prior to the start of investment operations: food security initiative, regional SME fund, joint infrastructure facility, sustainable energy initiative and joint work on the investment climate.

2. A PHASED APPROACH

2.1 Engagement in three phases

At the core of the extension of the Bank's mandate in support of the emerging Arab democracies is a proposed amendment of Article 1 AEB to expand the geographical scope of the Bank's mandate. As the process of acceptance by Members may well take some time, given the very high level of acceptances required, Resolution No. 134 requests that the Board of Directors recommend further measures that would enable the Bank to engage more rapidly in prospective new recipient countries.

The Board of Directors has therefore examined the possible establishment of cooperation funds and Special Funds, which would allow the Bank to become active in the new region before it can do so with its ordinary capital resources. The three resolutions recommended for adoption provide for a three-phase approach to the Bank's engagement:

- **First phase: technical assistance and similar activities funded by cooperation funds**. These would be funded by an allocation from EBRD net income as well as by donors, and could become operational as early as the fourth quarter of 2011, upon adoption by the Board of Governors of Resolutions amending Articles 1 and 18 AEB. The cooperation funds will be deployed on terms to be approved by the Board of Directors in agreement with the relevant donors. This is further explained in section 5.

- **Second phase: operations funded by Special Funds.** The use of Special Funds would enable the Bank to conduct its full range of operations as "special operations" (under Article 9 AEB) and could be set up as soon as Members accept an amendment of Article 18 AEB. This amendment could enter into force earlier than the amendment of Article 1 AEB. This is further explained in section 4.

- **Third phase: Ordinary operations funded by ordinary capital resources.** This would become possible upon acceptance by Members of the amendment of Article 1 AEB. This is further explained in section 3.

It should be understood that the timing of the second and third phases is dependent on action by Members. The Board of Directors recommends that Governors give their active support for a speedy acceptance process.

The Board of Directors recognises the importance of the EBRD having an early positive impact in the prospective new countries of operations and the time it might take before the proposed amendments to the AEB enter into force. Consequently, work will continue on developing cooperative approaches between MDBs, as well as with regional institutions, donors and other partners, that would allow investment opportunities prepared with EBRD involvement to be taken forward on a timely basis. [2] [3]

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[2] EBRD cannot make such investments in its name or take them on its books before creation of a Special Fund in Phase 2.

[3] The EU's Partnership for Democracy and Shared Prosperity with the Southern Mediterranean and the Deauville Partnership offer a framework for such cooperation.

The proposed Board of Governors' resolutions and consequent amendments to the AEB will only establish the Bank's ability in principle to operate in countries within the extended region. At each stage, decisions will need to be made on the eligibility of individual countries, based on a thorough assessment of developments in light of the principles of the Bank's mandate.

2.2 Assessments of conformity with the Bank's mandate

Article 1 AEB stipulates that the Bank use its resources in countries "committed to and applying the principles of multiparty democracy, pluralism and market economics". Article 11 AEB requires that the Board of Directors review at least annually the Bank's strategy in any recipient country to "ensure that the purpose and functions of the Bank, as set out in Articles 1 and 2... are fully served". These requirements are particularly pertinent in the current context of the Arab spring.

The Bank will apply its existing procedures for assessing Article 1 and 2 compliance to any new recipient countries. These procedures are applicable to all the Bank's recipient countries and are set out in *Procedures to Implement the Political Aspects of the Mandate of the European Bank for Reconstruction and Development* (BDS91-16). The political assessments will cover criteria such as free elections; a representative and accountable government; separation between state and political parties; independence of the judiciary; freedom of speech and peaceful assembly; freedom of conscience and religion; and others as may be established by the Board of Directors. In conducting the assessments, the Bank will, in accordance with its policies, consult with other institutions while taking account of internationally recognized reference points. The assessment methodology and criteria may be reviewed by the Board of Directors to confirm their comparability across countries and to take account of any additional aspects that may be of particular relevance to the extended region whilst respecting equal treatment between existing and future countries of operations.

While the criteria and reference points would be common to the assessments at each stage, the decisions and the ensuing operations represent different degrees of commitment by the Bank. It is therefore recommended that the first phase, namely commencing activities funded by cooperation funds, should carry different requirements for meeting the criteria of the Bank. In each phase, periodic reviews would enable the Bank to calibrate its engagement in light of developments. Specifically, the following approach is envisaged:

- **Prior to initiating activities funded from cooperation funds (first phase) in a country**: Management will prepare a detailed review of political and economic developments for consideration by the Board of Directors, drawing on the established reference points. The Board of Directors will consider whether the country's commitment to Article 1 AEB principles and general trajectory are consistent with meeting the political aspects of the Bank's purpose either at present or in the not-too-distant future. The country will be invited to assist this assessment by communicating its roadmap of reforms to the Bank.

- **Prior to initiating activities funded from Special Funds (second phase) in a country**: in order to be granted the status of *potential* recipient country in accordance with the revised Article 18 AEB, the Board of Directors needs to be satisfied that the country meets all the conditions of Article 1 AEB, except the geographical condition which is in the process of being amended. Accordingly Management will prepare a comprehensive political and economic assessment and, taking account of the review of factors and standards, the Board of Directors will determine whether the relevant country is committed to and applying the principles of multiparty democracy, pluralism and market economics as set out in Article 1 AEB. This determination will be confirmed by the Board of Governors in passing the resolution confirming the relevant country's status as a potential recipient country and reviewed periodically thereafter by the Board of Directors in accordance with the Bank's established procedures.

- **Prior to granting a country full access to the Bank's ordinary capital resources** (**third phase**), an update of the comprehensive political and economic assessment carried out for the second phase will be prepared. As with the second phase the Board of Directors and, prior to the commencement of operations, the Board of Governors will make a determination on the basis of that update as to whether the country is committed to and applying the principles of Article 1 AEB. This determination will be reviewed periodically thereafter by the Board of Directors in accordance with the Bank's established procedures.

2.3 A country and client driven approach

Each of the prospective new recipient countries faces a different set of circumstances and, despite the commonalities in their drive for change, will wish to set their own priorities. Political change has opened new spaces for citizens to express their views and, as in democracies elsewhere, has entitled them to be heard. At the same time, new constitutions and representative bodies are still in formation in some countries and transition priorities may emerge only gradually.

The Bank will need to be sensitive to this evolving environment and develop its own approach to transition in close consultation with the authorities and stakeholders in each country. The phased approach offers the benefit of allowing the Bank to familiarise itself with the circumstances and to engage with a broad range of clients and other stakeholders through technical assistance, advisory and analytical work as well as opportunities for dialogue before embarking on an investment strategy.

In this context, it will also be important for the Bank to collaborate closely and from the earliest stages with international institutions that have a long-standing presence in the region, including with regional partners.

The Board of Directors has noted that in addition to the need for the Bank to set out certain institutional orientations it will be necessary to manage expectations, especially in the emerging Arab democracies themselves. The Bank will refer to the complex and multi-dimensional transitions in Eastern Europe, the slow change in institutions, cultures and attitudes. It will emphasise the need for patience in seeing such change bear fruit, and argue for a mix of actions that address both these long-term aspirations as well as short-term popular expectations. In this context the Bank will be careful to describe its instruments and capabilities, and how short- and long-term objectives are best addressed in a coordinated manner with other MDBs and other institutional stakeholders.

3. AMENDMENT OF ARTICLE 1 AEB

3.1 Decisions to be taken

Article 1 AEB currently defines the region in which the Bank is to pursue its purpose as the countries of Central and Eastern Europe as well as Mongolia. As the prospective new recipient countries are outside that region, Article 1 AEB will need to be amended before the Bank is empowered to carry out operations there using its ordinary resources. An amendment of Article 1 AEB would have to be first approved by the Board of Governors and then accepted by the Members of the Bank in accordance with the requirements of Article 56 AEB.

The text of the proposed Resolution No. 137 is set out in Annex 1. In summary it provides that:

- Article 1 AEB be amended to extend the possible scope of the Bank's operations to include the countries of the Southern and Eastern Mediterranean;
- Article 1 AEB be amended to provide that a Member should become a recipient country with the approval of a qualified majority of no less than 2/3 of Governors, representing no less than 75% of the total voting power; and
- these amendments should enter into force seven days after the Bank has formally communicated to its Members that the requirements for accepting such a resolution have been met.

3.2 Proposed regional definition

In considering an appropriate extension to the geographic scope of the Bank's mandate, the Board of Directors considered notably the following factors:

- Shareholders' desire to support the emerging democracies of North Africa and the Middle East.
- The role of the Bank as a regional international financial institution.
- The Bank's capacity and capabilities, in terms of capital and skills.

Furthermore, Directors noted the distinction between expanding the region in which the Bank might potentially operate and the designation of individual countries within that region as recipient countries.

A narrow regional definition might leave out current or future aspirant democracies and therefore dilute the international community's offer of support for the Arab spring. A wide definition, in turn, would reduce the Bank's ability to provide a meaningful level of support without reducing the commitment to the existing countries of operations and without requiring additional capital. The Bank's comparative advantage relative to other institutions, in terms of skills and business model, would be less obvious in the very poor countries of the wider region.

A wide regional definition might still allow a case-by-case decision to be made on individual countries without necessarily approving a very large number. However, while such definition would not entitle any country in the wider region to be granted membership and recipient country status, it is questionable whether the Bank would be able to apply criteria for eligibility in such a highly selective manner.

The Board of Directors considers that a regional definition that strikes the right balance between these considerations would extend the geographic scope of Article 1 AEB to the Southern and Eastern Mediterranean region, consisting of the countries that have a shoreline on the Mediterranean as well as Jordan which is closely integrated into this region.

3.3 Proposed voting mechanism

The Board of Directors also considered the voting majority needed for the Board of Governors to approve a Member's request for recipient country status. The AEB provides no guidance in this regard. However in practice, in the previous 25 cases where recipient country status was granted to existing or new members, the Bank has applied the voting majority set out in Article 3 AEB (which only regulates the granting of membership in the Bank). Article 3 requires a qualified majority of no less than 2/3 of the Governors representing no less than 75% of the total voting power, though a much broader consensus has always been achieved.

It is therefore proposed, consistent with these precedents, that the decision that a country qualifies as a recipient country be taken by the Board of Governors by the affirmative vote of no less than 2/3 of the Governors representing no less than 75% of the total voting power of Members, although the Board of Directors anticipates that a broader consensus will be achieved.

3.4 Assessments made at time of recipient status confirmation

After the amendment of Article 1 AEB has entered into force and before recommending to the Board of Governors that a county be granted recipient country status, the Board of Directors would need to be satisfied that the country meets all the conditions of Article 1 AEB. As set out in section 2.2, based on a comprehensive assessment by Management, the Board of Directors, and then the Board of Governors, would determine whether or not the country is committed to, and applying, the principles of multiparty democracy, pluralism and market economics as set out in Article 1 AEB.

4. AMENDMENT OF ARTICLE 18 AEB

4.1 Decisions to be taken

The countries of the Southern and Eastern Mediterranean cannot become recipient countries before the proposed amendment of Article 1 AEB has come into force. However, in order to allow for an earlier involvement of the Bank in these countries, the Board of Directors proposes that, while awaiting the entry into force of Article 1 AEB as amended, the Bank be empowered to carry out operations financed from Special Fund resources, i.e., "special operations", in selected Member countries of the extended region. This would require an amendment of Article 18 AEB, which would have to be first approved by the Board of Governors and then accepted by Members in accordance with Article 56 AEB.

The text of the proposed Resolution No. 138 is set out in Annex 2. In summary it provides that:

- Article 18 AEB be amended to permit Special Funds to be used in the Bank's potential recipient countries;

- Article 18 AEB be amended to provide that a Member should be designated as a potential recipient country with the approval of a qualified majority of no less than 2/3 of Governors, representing no less than 75% of the total voting power; and

- these amendments should enter into force seven days after the Bank has formally communicated to its Members that the requirements for accepting such a resolution have been met.

The draft Resolution also contemplates that when the Board of Governors decides that a Member should be a potential recipient country, it should also decide the length of time for which that Member may be able to have access to the relevant Special Fund.

4.2 Concept of potential recipient country

Article 18 AEB enables the Bank to accept the administration of Special Funds which are designed to serve the purpose and come within the functions of the Bank, i.e., for use in its recipient countries. It is proposed to amend this provision to allow the Bank to use Special Funds in "potential recipient countries", namely any Member in which the Bank intends to operate with its ordinary resources once the conditions necessary for that country to become a recipient country, as set out in Article 1 AEB, are met. The intention of the Bank to operate in a given member country would have to be evidenced by at least two decisions of the Board of Governors: a decision to amend Article 1 AEB to include the region in which the country is located (as contemplated by draft Resolution No. 137) and a decision to declare that country a potential recipient country.

The proposal to amend Article 18 AEB draws on the intentions of the founders of the Bank in formulating Article 8.4 AEB, which allowed any one of the initial recipient countries to voluntarily limit its own access – in time and amount – to the Bank's ordinary capital resources and contemplated that, once such decision had been made, another decision of the Board of Governors, to be adopted at a high majority, would be required to allow that country to become a recipient country. Similarly, although in a different context, the amended Article 18 AEB would allow the Bank to provide any "potential recipient country" access to Special Funds resources. Assuming that the Special Funds will be partly sourced through net income allocations from the Bank (see Section 4.5) and recognising the Bank's financial constraints, this access would be limited in time and amount and intended only as a temporary mechanism to allow operations pending acceptance by members of the amendment of Article 1 AEB. The amendment would also acknowledge the possibility that the country may never become a recipient country (in accordance with the provisions of Article 1 AEB as amended), in which case the Bank's special operations in that country would be terminated and the Special Funds resources in that country wound up.

4.3 Proposed voting mechanism

As amended, Article 18 AEB would allow the Bank to use Special Funds in a potential recipient country, "for such limited period and under such terms as may seem advisable". The Board of Directors has considered whether the period of time during which a Member may qualify as a potential recipient country should be fixed once and for all (in Article 18 AEB, as revised) or should be determined on a case-by-case basis in respect of each country. Based on experience with Article 8.4[4] and in view of the diversity of situations and needs of the countries of the extended region, the Board of Directors has concluded that the latter option is preferable, provided that the time period decision was also taken by the Board of Governors at a qualified majority.

Accordingly the Board of Directors proposes that the decision that a country qualifies as a potential recipient country, and the period for which it should so qualify, should be taken by the Board of Governors by the affirmative vote of no less than 2/3 of the Governors representing no less than 75% of the total voting power of Members, on the same basis as set out in Section 3.3.

4.4 Assessments made at time of potential status confirmation

After the amendment of Article 18 AEB has entered into force and before recommending to the Board of Governors that a country be granted potential recipient country status, the Board of Directors would need to be satisfied that the country meets all the conditions of Article 1, except the geographical condition pending the entry into force of the relevant amendment. As set out in section 2.2, based on a comprehensive assessment by Management, the Board of Directors, and then the Board of Governors, would determine whether or not the country is committed to, and applying, the principles of multiparty democracy, pluralism and market economics as set out in Article 1 AEB.

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[4] Article 8.4 included a three year time period which proved unsuitable, when a fundamental change of circumstances – affecting the former Soviet Union – required a shorter time period.

4.5 Special Funds operations and financial capacity implications

The Board of Directors notes that Special Funds can be sourced both through net income allocations from the Bank and from third parties.[5]

It is anticipated that the Bank will have the financial capacity to be able to allocate sufficient net income to Special Funds to be able to support a gradual build up of special operations for a limited time period. During the operation of such Special Funds, the Bank's overall capital capacity will be preserved and the Bank's ability to fulfil the CRR4 objectives in its existing region of operations will not be affected.

After the amendment of Article 1 AEB comes into force and the Board of Governors grants recipient country status to a Member, the Special Fund funded by a net income allocation from the Bank will be terminated in respect of such country and the associated assets and 'capital' transferred to the ordinary capital resources of the Bank.[6] The medium term impact on the capital capacity of the Bank will be minimised as the Bank will have a future economic interest in the Special Fund assets that will be realised on Fund termination.

The rules and procedures for each of the Special Funds will be considered at a later stage and will be subject to approval by the Board of Directors[7]. It is anticipated that they will be designed such that the operational governance mirrors the governance over the Bank's ordinary operations, thus requiring the involvement of the Operations Committee and the Board of Directors.

These issues are further elaborated in Annex 5.

[5] Special Funds funded through allocations of the Bank's net income would be distinct from Special Funds funded by third party donors, and there would be a separate Special Fund for each potential recipient country, reflecting that periods of access to Special Funds resources would not necessarily coincide.

[6] The Board of Directors will, in due course, review options for asset disposal should operations in a potential recipient country be discontinued for any other reason.

[7] In the case of Special Funds financed by donors this will be done in agreement with the relevant donors.

5. USE OF COOPERATION FUNDS IN PROSPECTIVE RECIPIENT COUNTRIES

5.1 Decisions to be taken

A draft Resolution No. 139 proposed for adoption by the Board of Governors is attached as Annex 3. In summary it provides that:

- the Board of Governors confirms the Board of Directors' interpretative decision on the use of cooperation funds in Member countries of the Southern and Eastern Mediterranean; and

- the Board of Governors makes an initial net income allocation of EUR 20 million for the purpose of funding cooperation funds for use in the extended region.

5.2 Nature of cooperation funds and interpretative decision

The Board of Directors has noted that:

- from time to time, funds other than the Bank's ordinary capital resources and Special Funds resources are made available to the Bank in accordance with Article 20(1)(viii) AEB, which empowers the Bank to "conclude agreements of cooperation with any public or private entity or entities" and that, for that reason, these donor funds have been called "cooperation funds", and that

- exercising its interpretative power under Article 57 AEB, the Board of Directors has previously decided that the Bank may use such cooperation funds which are not Bank resources in non-Member countries ((Kosovo, 31 August 1999: BDS99-84) and in non-recipient Member countries (Mongolia, 28 March 2001***:*** BDS01-029 (F)) provided that such use is only made (a) in exceptional circumstances and (b) to implement purposes and carry out functions that are broadly compatible with those set forth respectively in Articles 1 and 2 AEB.

In view of the foregoing, the Board of Directors decided, on 26 July 2011, that the use of cooperation funds in Member countries of the Southern and Eastern Mediterranean was justified by exceptional circumstances and broadly compatible with the Bank's purpose and functions. A copy of the Board of Directors' decision is attached as Annex 4.

Under Article 57.2 AEB, an interpretative decision made by the Board of Directors may be referred to the Board of Governors for a final decision. Accordingly the Board of Directors recommends that the Board of Governors confirm the decision taken by the Board of Directors on 26 July 2011.

5.3 Assessments made at time access to cooperation funds is granted

Before granting access of individual prospective recipient countries to cooperation funds the Board of Directors will need to be satisfied that a number of conditions have been met. These conditions are set out in the Board of Directors’ Interpretative Decision of 27 July 2011, attached as Annex 4, and include among others, that the Board of Governors will have approved Resolutions 137 and 138. The Board of Directors will also have concluded that the country’s commitment to Article 1 principles and general trajectory are consistent with meeting the political aspects of the Bank's purpose either at present or in the not-too-distant future. The country will be invited to support this assessment by communicating its roadmap of reforms to the Bank.

Access to cooperation funds creates no presumption of future recipient or potential recipient status, and can be suspended or terminated if there is an adverse change in circumstances.

5.4 Required resources, funding approach and activities

A relatively high intensity of TC activities is foreseen, focused on investment project preparation and including also institutional and client capacity building, policy dialogue, and broad development of the Bank's capacity to deliver its transition mandate.

In addition, given significant barriers to investments and access to finance, the availability of other grant funded instruments, notably risk sharing and performance fees for MSME finance and investment grants for municipal infrastructure, will be required from an early stage. Early availability of resources for such instruments, as for TC activities, will enable preparation of investment projects prior to countries becoming eligible for investments. This will enable rapid implementation once the threshold for investment eligibility, initially through Special Funds, has been crossed.

TC and other grant funded instruments will be resourced through cooperation funds, providing an early signal of intent while retaining the ability to reverse direction, should this be called for.

Further work by the Board of Directors is required to agree on how the Bank should implement cooperation funds. But at the core of the proposed funding approach will be a cooperation agreement funded by net income allocation(s) as described below (section 5.5). Decision making over the use of these resources will lie with the Board of Directors, which may choose to delegate its authority for decisions on funding below a certain threshold amount to Management.[8] Governance arrangements will be set out in the cooperation agreement between the Bank and the third party channelling the net income allocation, the terms of which will be subject to Board of Directors' approval. It is anticipated that this cooperation agreement funded by a net income allocation will be used for project preparation, capacity building and policy dialogue as described in the first paragraph above.

The Bank will also seek to access resources from third parties, to be managed as bilateral or multi-donor cooperation funds. Their terms would be set out in cooperation agreements with the relevant donors and will be subject to Board of Directors' approval.

[8] This is the current practice with the EBRD Shareholder Special Fund

The Board of Directors notes that the magnitude of TC and other instruments that will be resourced from cooperation funds is very difficult to predict given uncertainties around the potential number of recipient countries, economic conditions, etc. However an envelope of EUR 100 million would provide a strong basis for the first 1 to 2 years of activities.

5.5 Net income allocation

Cooperation funds are donor funds which, when made available to the Bank, remain in the ownership of donors and do not become Bank resources. Bank resources – i.e., ordinary capital resources and Special Funds resources – may only be used to foster transition in recipient countries. This restriction does not apply to Bank resources which have been, as net income, either distributed to Bank Members or allocated to third parties for "other purposes" in accordance with Article 36.1 AEB. Once decided by the Board of Governors the funds made subject to such distribution and/or allocation no longer remain within the ownership of the Bank and may, accordingly, be contributed as cooperation funds by such Members and/or third parties.

The Bank may therefore make an allocation of net income to a designated third party subject to a requirement that an equal amount be made available by that third party to the Bank as cooperation funds, i.e. that the allocation be immediately returned.

In light of the foregoing, the Board of Directors proposes that the Board of Governors make an initial net income allocation of EUR 20 million for the purpose of funding a cooperation agreement for use in the extended region.

Additional contributions to cooperation funds by other donors would reflect the expectation that cooperation fund activities would ultimately assist the special operations and eventually ordinary operations of the Bank. The approach would be designed so as to enable consistency with the fees which donors currently pay for cooperation funds with the Bank. At such a time as countries become recipient countries following amendment of Article 1 AEB, the Bank's budget would bear the indirect expenses relating to cooperation funds, as it does today in the existing region of operations.

5.6 Governance

The governance structure for the envisaged cooperation funds will need to be considered further by the Board of Directors taking into account the views of the relevant donors. It is anticipated that the structure will include two layers of governance which will need to have a simple and effective design: i) cooperation agreements entered into with each entity that contributes to the cooperation funds, and ii) an Assembly convened in the first phase of cooperation funds activation, whose role will be to provide strategic orientations on use of the funds and to secure a high level of commitment and ownership from the beneficiary countries.

6. SUBMISSION TO THE BOARD OF GOVERNOR

In accordance with Section 10 of the Rules of Procedure of the Board of Governors, the Board of Directors has decided that this report and the Resolutions attached to it should be promptly submitted to each Governor with a request for a vote on the Resolutions on or before 30 September 2011, which deadline may be extended by the President. The Secretary General will promptly notify Governors of any such extension.

ANNEX 1 – RESOLUTION NO. 137

AMENDMENT OF THE AGREEMENT ESTABLISHING THE BANK IN ORDER TO ENABLE THE BANK TO OPERATE IN COUNTRIES OF THE SOUTHERN AND EASTERN MEDITERRANEAN

THE BOARD OF GOVERNORS

Observing the historic changes occurring in North Africa and the Middle East;

Recalling Resolution No. 134, *Possible Geographic Expansion of the Bank's Region of Operations* adopted on 21 May 2011, by which the Board of Governors asked the Board of Directors to make recommendations to the Board of Governors with respect to, *inter alia*, an amendment of Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development (the Agreement) providing for an appropriate regional extension to the geographic scope of the EBRD's mandate and an appropriate mechanism to grant recipient country status to member countries within such extended region, while ensuring that any such extension should not require additional capital contributions or compromise the agreed scope and impact of the Bank’s operations in the existing recipient countries;

Recalling also the confirmation in the Board of Directors' Report on the Fourth Capital Resources Review (CRR4) for the period 2011-2015, which was endorsed by the Board of Governors in Resolution No. 128, that graduation remains a fundamental principle for the Bank;

Having considered and being in agreement with the report of the Board of Directors to the Board of Governors on the *Geographic expansion of the Bank's Region of Operations to the Southern and Eastern Mediterranean* and its recommendations, *inter alia*, that the Board of Governors approve an amendment of Article 1 of the Agreement in order to enable the Bank to operate in countries of the Southern and Eastern Mediterranean;

NOW THEREFORE HEREBY RESOLVES THAT:

1. Article 1 of the Agreement be amended to read as follows:

"ARTICLE 1: PURPOSE

In contributing to economic progress and reconstruction, the purpose of the Bank shall be to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to and applying the principles of multiparty democracy, pluralism and market economics. **Subject to the same conditions, the** purpose of the Bank may also be carried out in Mongolia **and in member countries of the Southern and Eastern Mediterranean as determined by the Bank upon the affirmative vote of not less than two-thirds of the Governors, representing not less than three-fourths of the total voting power of the members.** Accordingly, any reference in this Agreement and its annexes to "Central and Eastern European countries", "countries from Central and Eastern Europe", "recipient country (or countries)" or "recipient member country (or countries)" shall refer to Mongolia **and each of such countries of the Southern and Eastern Mediterranean** as well."

2. Members of the Bank be asked whether they accept the said amendment by (a) executing and depositing with the Bank an instrument stating that such member has accepted the said amendment in accordance with its law and (b) furnishing evidence, in form and substance satisfactory to the Bank, that the amendment has been accepted and the instrument of acceptance executed and deposited in accordance with the law of that member.

3. The said amendment enter into force seven days after the date on which the Bank has formally confirmed to its members that the requirements for accepting the said amendment, as provided for in Article 56 of the Agreement Establishing the Bank, have been met.

(Adopted [ ])

ANNEX 2 – RESOLUTION NO. 138

AMENDMENT OF THE AGREEMENT ESTABLISHING THE BANK IN ORDER TO ALLOW THE USE OF SPECIAL FUNDS IN RECIPIENT COUNTRIES AND POTENTIAL RECIPIENT COUNTRIES

THE BOARD OF GOVERNORS

Considering that, in adopting Resolution No. 137, the Board of Governors would approve an amendment of Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development (the Agreement) pursuant to which the Bank would be authorised to carry out its purpose in the countries of the Southern and Eastern Mediterranean;

Recalling Resolution No. 134, *Possible Geographic Expansion of the Bank's Region of Operations* adopted on 21 May 2011, by which the Board of Governors asked the Board of Directors to make recommendations to the Board of Governors with respect to, *inter alia*, possible further steps to allow the Bank's operations to start as early as possible in prospective recipient countries of the extended region;

Having considered and being in agreement with the report of the Board of Directors to the Board of Governors on the *Geographic expansion of the Bank's Region of Operations to the Southern and Eastern Mediterranean* and its recommendations, *inter alia*, that the Board of Governors approve an amendment of Article 18 of the Agreement in order to enable the Bank to use Special Funds for special operations in potential recipient countries;

NOW THEREFORE HEREBY RESOLVES THAT:

1. Article 18 of the Agreement be amended to read as follows:

"ARTICLE 18: SPECIAL FUNDS

1. **(i)** The Bank may accept the administration of Special Funds which are designed to serve the purpose and come within the functions of the Bank **in its recipient countries and potential recipient countries**. The full cost of administering any such Special Fund shall be charged to that Special Fund.

   (ii) For the purposes of subparagraph (i), the Board of Governors may, at the request of a member which is not a recipient country, decide that such member qualifies as a potential recipient country for such limited period and under such terms as may seem advisable. Such decision shall be taken by the affirmative vote of not less than two-thirds of the Governors, representing not less than three-fourths of the total voting power of the members.

(iii) The decision to allow a member to qualify as a potential recipient country can only be made if such member is able to meet the requirements for becoming a recipient country. Such requirements are those set out in Article 1 of this Agreement, as it reads at the time of such decision or as it will read upon the entry into force of an amendment that has already been approved by the Board of Governors at the time of such decision.

(iv) If a potential recipient country has not become a recipient country at the end of the period referred to in subparagraph (ii), the Bank shall forthwith cease any special operations in that country, except those incident to the orderly realization, conservation and preservation of the assets of the Special Fund and settlement of obligations that have arisen in connection therewith.

2. Special Funds accepted by the Bank may be used **in its recipient countries and potential recipient countries** in any manner and on any terms and conditions consistent with the purpose and functions of the Bank, with the other applicable provisions of this Agreement, and with the agreement or agreements relating to such Funds.

3. The Bank shall adopt such rules and regulations as may be required for the establishment, administration and use of each Special Fund. Such rules and regulations shall be consistent with the provisions of this Agreement, except for those provisions expressly applicable only to ordinary operations of the Bank."

2. Members of the Bank be asked whether they accept the said amendment by (a) executing and depositing with the Bank an instrument stating that such member has accepted the said amendment in accordance with its law and (b) furnishing evidence, in form and substance satisfactory to the Bank, that the amendment has been accepted and the instrument of acceptance executed and deposited in accordance with the law of that member.

3. The said amendment enter into force seven days after the date on which the Bank has formally confirmed to its members that the requirements for accepting the said amendment, as provided for in Article 56 of the Agreement, have been met.

(Adopted [ ])

ANNEX 3 – DRAFT RESOLUTION NO. 139

CONFIRMATION OF INTERPRETATION OF THE AGREEMENT ESTABLISHING THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT AND NET INCOME REALLOCATION

THE BOARD OF GOVERNORS

Considering that, in adopting Resolution No. 137, the Board of Governors would approve an amendment of Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development (the Agreement) pursuant to which the Bank would be authorised to carry out its purpose in the countries of the Southern and Eastern Mediterranean;

Considering that, in adopting Resolution No. 138, the Board of Governors would approve an amendment of Article 18 of the Agreement pursuant to which the Bank would be authorised to use Special Funds resources in potential recipient countries;

Recalling Resolution No. 134, *Possible Geographic Expansion of the Bank's Region of Operations* adopted on 21 May 2011, by which the Board of Governors asked the Board of Directors to make recommendations to the Board of Governors with respect to, *inter alia*, possible further steps to allow the Bank's operations to start as early as possible in prospective recipient countries of the extended region;

Having considered and being in agreement with the report of the Board of Directors to the Board of Governors on the *Geographic expansion of the Bank's Region of Operations to the Southern and Eastern Mediterranean* and its recommendations, *inter alia*, that the Board of Governors confirm the Board of Directors' interpretation regarding the use by the Bank of cooperation funds in such countries and make a net income allocation designed to facilitate such use; and

Noting that the Bank has sufficient surplus available for reallocation in accordance with Article 36.1 of the Agreement;

NOW THEREFORE HEREBY RESOLVES:

1. In accordance with Article 57 of the Agreement, to confirm the Board of Directors' decision that the use by the Bank of cooperation funds in member countries of the Southern and Eastern Mediterranean prior to the entry into force of the proposed amendments to Articles 1 and 18 of the Agreement is justified by exceptional circumstances and is broadly compatible with the purpose and functions of the Bank provided that the conditions set out in Annex 4 of the report of the Board of Directors referred to above are satisfied.

2. In accordance with Article 36.1 of the Agreement to reallocate to other purposes an aggregate amount of EUR 20 million of net income previously allocated to surplus, in favour of the European Investment Bank (EIB) and/or the International Bank for Reconstruction and Development (IBRD) as trustee for a Financial Intermediary Fund for the Southern and Eastern Mediterranean, subject to the conclusion of a cooperation agreement with the Bank to finance technical cooperation and similar activities of the Bank in those member countries of the Southern and Eastern Mediterranean in respect of which the conditions set out in Annex 4 of the report of the Board of Directors referred to above are satisfied.

3. To empower the Board of Directors to determine how the aggregate amount, as referred to in the previous paragraph, shall be allocated to such institution or institutions.

4. To make the effectiveness of this Resolution subject to the adoption by the Board of Governors of Resolutions Nos. 137 and 138.

(Adopted [ ])

ANNEX 4 – INTERPRETATIVE DECISION OF THE BOARD OF DIRECTORS

REGARDING THE USE OF COOPERATION FUNDS IN PROSPECTIVE RECIPIENT COUNTRIES OF THE SOUTHERN AND EASTERN MEDITERRANEAN, DATED 26 JULY 2011

On 26 July 2011, in the context of the possible geographic extension of the Bank's region of operations to countries of the Southern and Eastern Mediterranean,

- Having noted that, from time to time, funds other than the Bank's ordinary capital resources and Special Funds resources are made available to the Bank in accordance with Article 20(1)(viii) of the Agreement Establishing the European Bank for Reconstruction and Development (AEB) – which empowers the Bank to "conclude agreements of cooperation with any public or private entity or entities" - and that, for that reason, these donor funds are referred to "cooperation funds".

- Having further noted that, exercising its interpretative power under Article 57 AEB, the Board of Directors has previously decided that the Bank may use these cooperation funds, which are not Bank resources, in non-Member countries ((Kosovo, 31 August 1999: BDS99-84) and in non-recipient Member countries (Mongolia, 28 March 2001***:*** BDS01-029 (F)) provided that such use is only made (a) in exceptional circumstances and (b) to implement purposes and carry out functions that are broadly compatible with those set forth respectively in Articles 1 and 2 AEB,

the Board of Directors decided that the use of cooperation funds in countries of the Southern and Eastern Mediterranean was justified as follows:

(a) Exceptional circumstances

On 21 May 2011, the Board of Governors observed the historic changes occurring in extended region and considered the urgent need to express support to those countries of the region determined to build a new and democratic order. In that context, the Board of Governors resolved to request the Board of Directors to make recommendations regarding (i) an amendment of Article 1 AEB providing for an appropriate extension to the geographic scope of the EBRD's mandate to that region and (ii) possible further steps to allow the Bank's operations to start as early as possible in prospective recipient countries of the extended region. In addition, at their May 2011 meeting in Deauville, G8 leaders pledged to work with the EBRD towards the creation of a 'dedicated transitional facility', to allow the Bank's operations in countries of the extended region to start as early as possible.

In view of these requests and their context, the Board of Directors concluded that, once the Board of Governors has approved the amendments to Articles 1 and 18 AEB and prior to their entry into force, exceptional circumstances will exist for the use of cooperation funds in those member countries of the extended region which are prospective recipient countries.

(b) Broad compatibility with the Bank's purpose and functions

In view of such exceptional circumstances, and consistent with the 1999 and 2001 decisions referred to above, the Board of Directors decided that the use of cooperation funds in countries of the Southern and Eastern Mediterranean, prior to the entry into force of the amendments to Articles 1 and 18, will be broadly compatible with the Bank's purpose and functions if the following conditions are satisfied:

1. the Board of Governors will have adopted a resolution to amend Article 1 of the AEB for the purpose of extending the Bank's geographical region of operations to counties of the extended region; and such resolution will have been submitted to members for acceptance in accordance with Article 56 of the AEB;

2. the Board of Governors will have adopted a resolution to amend Article 18 of the AEB for the purpose of allowing the Bank to carry out operations funded by Special Funds in countries that are outside of the Bank's current region of operations but within the proposed extended region; and such resolution will have been submitted to members for acceptance in accordance with Article 56 of the AEB;

3. in respect of any country of the extended region, such country will be a member of the Bank at the time of use of cooperation funds and will have expressed its interest in becoming a recipient member country of the Bank;

4. in respect of any country of the extended region, the Bank will have made a technical assessment of the economic and political conditions existing in the country and, based on such assessment, the Board of Directors will have concluded that the country’s commitment to Article 1 principles and general trajectory are consistent with meeting the political and economic requirements of Article 1 of the AEB either at present or in the not-too-distant future, and that conclusion remains valid;

5. in respect of any country of the extended region, the Bank has not abandoned the process of acceptance of the amendments to Article 1 and 18 of the AEB;

6. in respect of any country of the extended region in which the Bank proposes to use cooperation funds, the Bank will be satisfied that the status, privileges, immunities and exemptions of the Bank and persons connected with the Bank extends to cooperation funds activities.

Annex 5 – CAPITAL HEADROOM CALCULATIONS AND FINANCIAL CAPACITY IMPLICATIONS OF SPECIAL FUNDS

1. *Capital headroom calculations*

The 'Capital Utilisation Analysis on Proposed Extension of the EBRD's Geographical Mandate' (SGS11-200 (Addendum 1)) examined the operational and capital capacity of the Bank in the context of the new region. This analysis built on 'Operational Scenarios and Capital Utilisation Analysis Technical Note' (SGS11-118 (Addendum 1)).

The Bank would initially make investments through Special Funds funded by net income allocations, and/or, Special Funds funded by donors (on the amendment of Article 18 and approval of potential recipient country status). It is understood that those Special Funds which are funded by net income allocations would be structured so that on approval of recipient country status (following Article 1 amendment), the assets and 'capital' of the Special Funds would be transferred to the Bank's ordinary capital resources. [9] Although ordinary capital resources and Special Funds resources are held separately from each other, the projections of capital utilisation in this annex have been calculated 'as if' the Bank was operating through ordinary capital resources from the start.

The analysis illustrated that the Bank has the capital capacity to gradually build up annual business volume in addition to the business volumes agreed in CRR4, to reach an additional €2.5 billion annual business volume by 2015[10]. An annual business volume of €11.0 billion is estimated to be sustainable beyond 2015, whilst still remaining within the Bank's statutory and economic capital constraints.

These illustrative projections are based on updating the CRR4 base case projections to reflect actual 2010 results and the 2011 Business Plan. The underlying assumptions for 2012-2015 remain unchanged. These projections were rolled forward beyond 2015 based on high level estimates broadly consistent with the operational and financial projections used in CRR4.

[9] The Board of Directors will, in due course, review options for asset disposal should operations in a potential recipient country be discontinued for any other reason.

[10] In addition to €8.5 billion of annual business volume in existing countries of operations under CRR4.

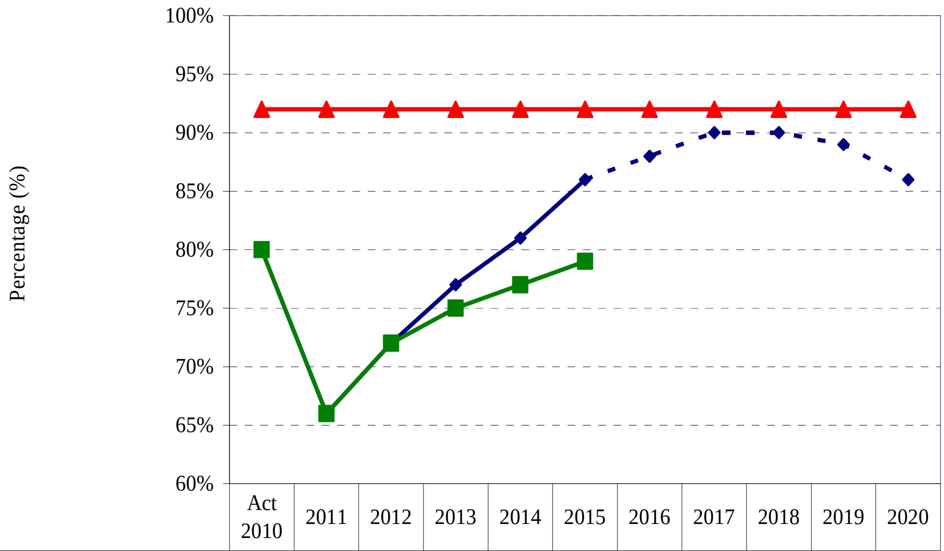
Table A5.1: Impact of the new region on annual business volume and operating assets 2010-2020

€ billion	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**
Updated CRR4 projections											
Annual business volume	9.0	9.0	9.0	8.5	8.5	8.5	n/a	n/a	n/a	n/a	n/a
Operating assets - planning rate	21.7	24.4	27	28.9	30.5	31.8	n/a	n/a	n/a	n/a	n/a
Including incremental ABV to €2.5 billion											
Annual business volume	9.0	9.0	9.5	9.5	10.0	11.0	11.0	11.0	11.0	11.0	11.0
Incremental ABV			*0.5*	*1.0*	*1.5*	*2.5*					
Operating assets - planning rate	21.7	24.4	27.2	29.7	32.1	34.6	36.5	38.6	40.0	41.0	41.5

Table A5.2 presents the Bank's projected statutory capital utilisation compared to the 92% prudential threshold based on updated CRR4 base case projections and projections including a gradual build up to €2.5 billion additional annual business in the new region in 2015.

Statutory capital utilisation is projected to be around 7% above the updated base projections by end 2015 at 86%. The statutory capital utilisation is projected to increase from 86% in 2015 to 90% in 2017/2018, before declining to 86% in 2020.

Table A5.2: Impact of the new region on statutory capital utilisation 2010-2020



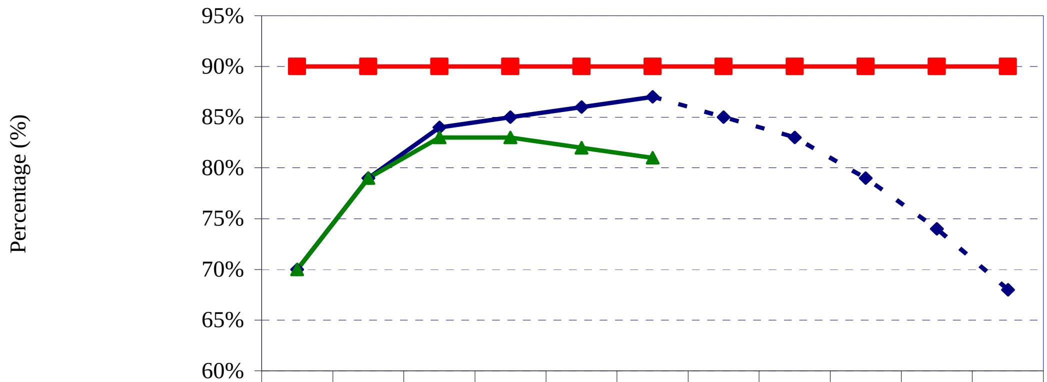
	Act 2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Incremental ABV to €2.5 billion	80%	66%	72%	77%	81%	86%	88%	90%	90%	89%	86%
Updated CRR4 base case	80%	66%	72%	75%	77%	79%					
92% threshold	92%	92%	92%	92%	92%	92%	92%	92%	92%	92%	92%

Table A5.3 shows that economic capital utilisation based on the illustrative scenario of €2.5 billion in incremental annual business volume is projected to rise from 70% at end 2010 to 87% at end 2015 (6% above the updated base projections).

Economic capital utilisation is projected to peak in 2015 at 87% and to then resume a downward trend, remaining below the Bank's 90% prudential threshold throughout.

The Bank's Core Tier 1 Basel ratio is projected to be in a range of 20% to 22% at end 2015 and is expected to increase beyond the CRR4 period.

Table A5.3: Impact of the new region on economic capital utilisation 2010-2020



	Act 2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Incremental ABV to €2.5 billion	70%	79%	84%	85%	86%	87%	85%	83%	79%	74%	68%
Updated CRR4 base case	70%	79%	83%	83%	82%	81%					
90% threshold	90%	90%	90%	90%	90%	90%	90%	90%	90%	90%	90%

Capital utilisation will remain well within the 92% prudential threshold. In the period 2012 to 2014 statutory capital is projected to peak at 81% if ordinary capital resources and Special Funds resources are aggregated. The maximum conceivable increase in this statutory utilisation when considering ordinary capital resources only would be around 3% higher.

The projections assumed beyond the CRR4 period are naturally highly subject to uncertainty and volatility with potential downside or upside for both operational and financial parameters. However, these projections have been developed on a prudent basis. These projections provide an indicative assessment of the operational and capital capacity of the Bank; there is no pre-judgement as regards the fifth Capital Resources Review ('CRR5').

2. *Funding of Special Funds from net income allocation*

The extent to which the Bank can make net income allocations to 'other purposes' in favour of Special Funds is limited to the amount of accumulated surplus (unrestricted general reserves) in excess of EUR 3.0 billion (being 10% of the Bank's authorised share capital). Any such net income allocations reduce the Bank's ordinary capital resources and therefore would reduce the Bank's statutory capital headroom until the assets of the Special Funds are reintegrated in the Bank's balance sheet upon termination.[11] Appropriate modalities will be established for the allocation of Bank net income to such Special Funds so as to not significantly affect the Bank's Economic Capital.

It is therefore anticipated that the Bank will have the financial capacity to be able to allocate sufficient net income to Special Funds to support a gradual build up of special operations for a limited time period. As an initial indication it is projected that as at the end of 2011 the maximum amount of accumulated net income that the Bank could allocate to Special Funds (following Amendment of Article 18 AEB) would be in the region of EUR 1 billion, which would increase statutory capital utilisation from 66% to 68%. The Bank is projected to generate net income of around EUR 0.8 billion per year in 2012 and 2013, further increasing the capacity to make net income allocations to Special Funds.

[11] For management purposes statutory capital utilisation ratios will also be estimated for the Bank and Special Fund on an aggregated basis to reflect the situation 'as if' Article 1 was amended and the Special Fund terminated.