DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

10th June 2022

RISK APPETITE STATEMENT

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Risk Appetite Statement

1. Purpose and Governance

1.1 The Risk Appetite Statement ("this Statement") provides a comprehensive summary of Risk Appetite parameters guiding the operations of the EBRD ("the Bank"). Its main purpose is to facilitate concise presentation and informed periodic review of the amount of risk the Bank is prepared to take in its key activities. It reflects market practice, enhances the quality of internal decision-making, and helps build Bank-wide risk awareness culture. It assists the Bank in communication with stakeholders, including investors, donors and rating agencies, supporting continued access to funding and ability to pursue the Bank's objectives.

1.2 The document provides a consolidated overview of how various types of risk are governed at the Bank. The following sections 2 and 3 describe the main principles underpinning risk appetite articulation and the overarching risk governance structure. The next section 4 introduces Financial Loss Tolerance Thresholds (FLTTs) which are assessed against the results of the annual Bank-wide stress test. The FLTTs form part of the articulation of risk appetite for number of financial risks. Section 5, 6, 7 and 8 then set out in detail key aspects of the Bank's risk appetite for each risk type including capital and leverage risk, liquidity risk, credit risk, market risk, operational risk and reputational risk. Detailed risk type definitions and metrics used for risk measurement and limitation can be found in Annex 2.

1.3 Most of the parameters described in this Statement have been adopted by Management and the Board of Directors ("the Board") through dedicated policy instruments. These are referenced throughout the paper. This Statement will be updated annually to reflect changes in such underlying policies.

1.4 The document is prepared and updated periodically by the Vice President Risk & Compliance Chief Risk Officer ("CRO") in consultations with other executive managers of the Bank.

2. Key Principles

2.1 The Bank achieves its strategic objectives by assuming risk. Without appropriate limitation, these risks have the potential to threaten its key resources including net earnings, capital, liquidity and reputation. In turn, these risks could therefore undermine the trust and confidence our stakeholders, including shareholding governments, clients, donors, civil society organisations and other relevant bodies, have in the Bank, its Management, and its strategy. At the extreme, these risks could necessitate request for callable capital or even threaten the existence of the Bank.

2.2 To ensure that the risk profile of the Bank does not facilitate such undesirable outcomes, based on Management's recommendation, the Board adopts a set of Risk Appetite parameters articulated in this Statement and other policy documents as appropriate. These parameters guide both strategic planning and day-to-day decisions, thereby avoiding excessive risk taking and encouraging the development of robust controls to protect the key resources of the Bank.

2.3 In aggregate, the key resources that facilitate the achievement of the Bank's objectives and simultaneously maintain confidence in the Bank's resilience in the face of adverse events underpin the triple-A (best in class among IFIs) rating. This rating is considered to be a vital component of the operating model of the EBRD. The Risk Appetite parameters have been calibrated to ensure its continuation.

2.4 Management is required to establish and maintain an appropriate infrastructure (including risk measurement, limits, rules, guidelines, independent decision-making, controls, monitoring, testing and reporting) to ensure that this Risk Appetite is complied with and to provide reports in the form of annual Bank-wide stress tests and quarterly risk reporting to evidence compliance.

3. Risk Governance Architecture

3.1 The overall Risk Governance of the Bank is anchored in the Agreement Establishing the Bank ("the AEB"). In accordance with Article 1 of AEB, the Bank puts its capital at risk in pursuit of its mandate to promote transition towards market oriented economic systems in its countries of operations.

3.2 The Bank seeks to protect and build up its capital in order to support an enhanced range of activities and enable the Bank to withstand negative impact to its capital due to financial losses resulting from credit, market or other financial risks. Consistent with Article 13(i) of the AEB, the Bank complies with sound banking principles to all its operations, which implies alignment with market practice in terms of assessing, measuring and managing the risks faced by the Bank.

3.3 The Bank follows market practice by reference to common standards of corporate governance, banking regulation and market practice in the banking industry. Additional reinforcement comes from the wider objectives of the Bank, whereby the Bank wishes to deploy capital appropriately, to achieve adequate overall return on the risks borne, to support its financial sustainability, and to mitigate against potential excessive losses that would deplete its medium term operational capacity.

3.4 To achieve this, the Bank puts in place checks and balances to ensure that:

- Investment decisions are not unduly influenced by business targets and that risks are fully considered to ensure that there is a good prospect of avoiding losses.
- The build-up of any material correlated risks is identified, reviewed and where appropriate acted upon.
- Controls are adequately designed around all material risks, robustly implemented and rigorously tested, to ensure Management is agile to act on evolving risk profiles.

3.5 Within the context of the Bank's overall governance structure, the Vice President, Risk & Compliance CRO is responsible for ensuring independent risk management of the Banking and Treasury exposures including corporate recovery matters, operational risk and information security, and for ensuring the review and compliance of the Bank's activities with environmental policies and procurement policies, and implementing related policy initiatives. The responsibility of the Vice President, Risk & Compliance CRO for financial controls carried out in connection with operational risks is shared with the Vice President, Finance CFO.

3.6 The Vice President, Risk & Compliance CRO is a member of the Executive Committee and reports to the President. Furthermore, the Audit Committee of the Board of Directors regularly meets with the Vice President, Risk & Compliance CRO without other members of management being present, on matters concerning the risk management function.

3.7 The Bank's overall framework for identification and management of risks is underpinned by:

- Shared responsibility by all staff members to identify and manage risks they incur in the course of fulfilling their responsibilities ("first line of defence"). This includes risk control activities performed within the first line of defence functions, such as peer reviews within Banking or liquidity and capital management controls operated within the Finance Vice Presidency.
- Independent, empowered and appropriately resourced "second line of defence" functions with control responsibilities for matters falling into their areas of competence, including Risk Management in respect of credit, market, liquidity, capital management and operational risks, the Office of the Chief Compliance Officer in respect of operational risk specifically related to conduct and integrity risk, the Environmental and Sustainability Department in respect of operational risks specifically related to environmental and social impact risks, and the

Procurement Policy and Advisory Department in respect of procurement related issues.

- Internal Audit Department, which acts as "third line of defence", and independently assesses the effectiveness of the processes within the first and second lines of defence.

3.8 In discharging the duties of the role, the Vice President, Risk & Compliance CRO is supported by several departments, as well as by the Risk Committee. The Risk Committee is chaired by the Vice President, Risk & Compliance CRO. 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. Its membership comprises senior managers across the Bank including representatives from Risk Management, Finance, Banking and the Office of the General Counsel.

3.9 Risk Management (i) provides an independent assessment of risks associated with individual investments undertaken by the Bank, (ii) performs an ongoing review of the portfolio to monitor the risk presented by investments from inception to repayment or exit, (iii) assesses and proposes ways to manage risks arising from correlations and concentrations within the portfolio, and (iv) ensures that adequate systems and controls are put in place for identification and management of operational risks across the Bank. Working together with other departments and units, Risk Management develops and maintains relevant policies for Banking and Treasury operations and promotes risk awareness across the Bank.

3.10 In exercising its responsibilities, Risk Management aims to:

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

3.11 The Bank's Office of the Chief Compliance Officer (OCCO) is responsible for independently managing the integrity risks arising from the Bank's operations and its clients and proposed clients, and for ensuring that the Bank has adopted appropriate standards on anti-money laundering; counter-terrorist financing; conflicts of interests; insider trading; Prohibited Practices; treatment of confidential information; and integrity and domiciliation due diligence that are in line with, or reflect, internationally accepted norms.

3.12 In accordance with its terms of reference, the Audit Committee of the Board of Directors periodically reviews and evaluates the functions performed by the Internal Audit Department, Office of the Chief Compliance Officer, Evaluation Department and Risk Management Department. The Audit Committee regularly meets with the heads of all these functions, without other members of Management being present.

4. Financial Loss Tolerance Thresholds

4.1 Notwithstanding its strong capitalisation consistent with triple-A (best in class among IFIs) rating, the Bank also wishes to manage its business to avoid excessive losses and depletion of capital in a stressed economic environment. In particular, the Bank wishes to retain its triple-A rating with a high degree of probability and does not wish to be forced to substantially revise its business plan due to a normal cyclical downturn.

4.2 The Bank adopts key warning indicators that it wishes to heed, to avoid undue loss of capital and to be able to adjust its business plan and strategy well before its triple-A rating is in jeopardy. These thresholds highlight that the risk taking is approaching the boundaries set out in the Bank's policies. Such warning signals facilitate early discussion of the approaching threats and, if appropriate, provide time to implement risk mitigating actions. They form a part of the broader business planning conversation, which is already informed by the financial performance of the Bank and the forward looking assessment of risks to profitability included in regular reports of the Bank. They facilitate a comprehensive discussion of the Bank's business plan and consideration of the associated risks.

4.3 The assessment of the Bank's risk profile against the parameters is made through the Annual Bank-wide Stress Test. The test is based on statistical forward looking analysis of the properties of the Bank's Balance Sheet and not against the actually observed financial performance in any given year.

4.4 A breach of any of the thresholds implied by the business plan set out in the annual Strategy Implementation Plan ("SIP") will prompt Management either (i) to accept the increased potential losses and elevate the thresholds accordingly or (ii) to adjust the business plan to keep the Bank's risk profile within the previously agreed parameters. This decision must be made by Management in the context of the annual approval of the Bank's SIP and disclosed to the Board as part of the process.

4.5 The levels of the FLTTs are expected to evolve based on (i) advances in modelling techniques and understanding of risks, (ii) changes to external environment, including volatility of financial markets, (iii) changes in the size and structure of the Bank's balance sheet, including e.g. size of the equity portfolio, (iv) changes in business plan and priorities and other relevant factors.

4.6 The thresholds include the Capital FLTT which is measured against the projected capital utilisation and the profit and loss FLTT ("P&L FLTT") which is measured against Net Earnings and associated change in Available Capital. Both thresholds are assessed in any given year of the stress test horizon.

4.7 The Capital FLTT is designed to constrain the overall risk adjusted balance sheet growth and the purpose of the P&L FLTT is to avoid excessive net earnings volatility mainly driven by the share of equity investments in the Banking book.

4.8 The thresholds are tested under two scenarios including a 1 in 7 Downturn and a 1 in 25 Severe scenario. The 1 in 7 Downturn scenario is likely to correspond to a cyclical economic slowdown or mild recession, whereas the 1 in 25 Severe scenario is likely to resemble a deep recession induced by an international financial or political event. In abstract terms, the Bank has a 1 in 7 and 1 in 25 probability of such loss levels occurring any year of its business plan and therefore sets its Risk Appetite at these probability levels.

4.9 The level of the Capital FLTT is set out further below under Capital and Leverage Risk Appetite in section 5.4. The level of the P&L FLTT mainly constrains the level of market risk from equity investments in the Banking book and is set out under section 7.3 and 7.4. The P&L FLTT is also influenced by the level of NPL and impairment charges, further incentivising management action in case of severe portfolio deterioration.

5. Capital, Leverage and Liquidity Risk Appetite

Capital and Leverage Risk Appetite

5.1 The Bank's capital, leverage and liquidity risk appetite defines the amount of capital and liquidity to be held in support of the Bank's business operations. The minimum amounts of capital and liquidity are calibrated to allow the Bank to maintain its triple-A credit rating, with particular reference to the Standard & Poor's ("S&P") methodology, under both normal and stressed economic conditions.

5.2 The Bank's Capital Adequacy Policy sets out the amount of capital to be held under normal economic conditions and determines required capital for debt and equity exposures within the banking book, gross treasury assets, as well as operational risk exposure.

5.3 As one of the key control parameters, under normal economic conditions, the Bank manages the minimum amount of capital by ensuring that the capital utilisation ratio does not exceed a 90% prudential limit.

5.4 The Capital FLTT measure capital utilisation inherent in the SIP business plan under stressed economic conditions defined as a 1 in 7 and 1 in 25 year event. They must not exceed 100% in any given year after taking into account institutional actions in response to a crisis. This is equivalent to a drop in terms of S&P Risk Adjusted Capital ratio that should in principle allow the Bank to retain its triple-A rating from S&P if other factors, such as perceived shareholder support, business profile and liquidity, remain positive.

Liquidity Risk Appetite

5.5 The minimum amount of liquidity to be held by the Bank is set out in the Treasury Authority and Liquidity Policy.

5.6 Given that the Bank does not have access to funding sources such as deposits or central banks, it must be able to meet its commitments in both normal and disrupted/closed financial markets for an agreed survivability period. In addition, the Bank needs to retain sufficient high-quality liquidity, so that under the rating agencies' methodologies liquidity should always be considered a strong/positive factor within the overall rating.

5.7 The key parameters set out in the Treasury Authority and Liquidity Policy are summarised below for ease of reference:

- The Bank is able to meet its obligations for at least *12 months under an Extreme Stress scenario*, defined as a 1 in 100 year event under the Bank's stress test methodology, without access to funding markets.
- The Bank's liquidity position is *perceived as robust by rating agencies and investors*. In particular, the Bank should ensure that at least 75% of the next two years' net cash flow requirements can be met, without recourse to accessing funding markets.
- The Bank should maintain additional liquidity, to be able to step out of unfavourable markets *for at least three months* and still be in compliance with the long term liquidity requirements set out above. This gives the Bank the ability to opt out of a potentially expensive borrowing market and avoid having to sell long dated securities at a potential loss, without putting at risk its long-term liquidity position.

5.8 The above metrics are supplemented by more granular limits set in Management level procedures, measuring liquidity over different time horizons and at individual currency level.

6. Credit Risk Appetite

6.1 Credit risk arises in the Bank's Banking and Treasury books. As part of its Banking operation, the EBRD invests in debt, guarantee and other products with international and local clients in its Countries of Operations ("CoO"). In fulfilment of its Treasury mandate, the Bank also invests world-wide in high quality liquid assets.

Banking book

6.2 The Bank protects itself from undue idiosyncratic (transaction specific) credit risk related to Banking transactions by carefully selecting and structuring individual investments, including by taking security over movable and immovable assets, by accepting guarantees from companies and individuals, and by requiring a set of financial and operational covenants, as well as by imposing associated reporting obligations. Residual credit risk is further minimised by targeted use of other risk mitigation instruments, such as unfunded risk participations or various funded and unfunded forms of donor support.

6.3 The Bank manages systemic (correlated) credit risk by adopting portfolio limits, including country limits, to reduce the impact of adverse external events on its capital. The Bank's prudential limits covering country and single obligor Banking exposures are articulated in the Capital Adequacy Policy approved by the Board. The Bank manages exposure to individual transactions and clients by mobilising private-sector co-financiers (both on a funded and on an unfunded basis) and/or through using concessional donor funding alongside its own loans.

6.4 These prudential limits are supplemented by Management level operational limits as appropriate, to contain and manage concentration risk at the level of country and single obligor.

6.5 To identify emerging risk and enable appropriate risk mitigating actions, the Bank also conducts regular 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 and the illiquid nature of emerging markets within which the Bank operates.

6.6 The Bank's business planning process, encapsulated in the SIP, sets balanced objectives in terms of geographical, sector and product distribution of Banking activities, taking into account the level of available capital and the desired risk profile of the Bank set out in this Statement.

6.7 The Bank's credit risk profile benefits from its special status as an international financial institution and under the AEB. In particular, the Bank's preferred creditor status may provide protection against sovereign default and currency convertibility risks.

6.8 Recognising that taking credit risk in Banking activities is central to the pursuit of its mandate and mission, the Bank does not impose a separate overall limit on credit risk in the Banking portfolio. The overall amount of credit and market risk in the Banking portfolio is instead controlled through capital and leverage risk parameters set out in section 5 above, with all other types of financial risks tightly constrained to maximise headroom available for the core activities.

Treasury book

6.9 Idiosyncratic and systemic credit risks related to Treasury portfolio are managed through a comprehensive set of portfolio and counterparty level limits articulated in the Treasury Authority and Liquidity Procedures, as updated from time to time. In addition, the Bank mitigates counterparty credit risk, for example by holding collateral against exposures to derivative counterparties.

6.10 The Bank's Treasury has narrowly defined set of objectives, which focus on (i) the provision and preservation of liquidity to support the Bank’s business plan and operations; (ii) the management of the capital of the Bank, retained earnings and borrowed funds; and (iii) local capital market development and provision of local currency funding in the Bank’s Countries of Operations. The Bank’s Treasury Department seeks to satisfy minimum liquidity criteria, while maintaining appropriately low credit risk and capital consumption associated with liquid asset portfolio.

6.11 Eligible Treasury counterparties and investments are normally limited to investment grades, with the exception of counterparties approved for local currency activities in the economies 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.

6.12 The overall amount of credit risk in the Treasury book, measured by a default value at risk (DVaR) at a one day time horizon and 99.99% confidence level, is capped at 10% of the Bank’s available capital. This limit is supplemented by risk adjusted counterparty and sub-portfolio limits, constraining single name exposures and various risk concentrations.

7. Market Risk Appetite

7.1 Market risk arises from both the Bank’s Banking and Treasury books. As part of its Banking operation, the Bank is exposed to market risk from equity investments with international and local clients in its Countries of Operations (“CoO”). Alongside its equity operation, the Bank is also exposed to residual market risk from imperfect hedging of assets and liabilities in terms of tenor, currency and interest rates.

Banking book equity investments

7.2 The Bank accepts high level of market risk related to its Banking equity investments entered in pursuit of its strategic objectives. The Bank does not in principle directly hedge currency risk or local equity market movements. As such, these risks are a significant contributor to annual volatility in the Bank's financial results. Hybrid investments (i.e., quasi debt / quasi equity) are hedged on a case by case basis, as determined by Treasury.

7.3 The Bank constrains associated volatility in financial results and, in turn, the size of its equity operation by the P&L FLTT, which are calculated based on the SIP business plan subjected to the 1 in 7 and 1 in 25 years stress scenario as defined under the Bank's stress testing methodology.

7.4 In the 1 in 7 years stress scenario, designed to replicate a cyclical downturn, Net Earnings and the change in Available Capital must not be negative by more than €1.0 billion in any single year. In the 1 in 25 years stress scenario designed to replicate a material once in a generation downturn, Net Earnings and the change in Available Capital in a single year after taking into account Institutional Actions must not be negative by more than €3.0 billion.

7.5 If the P&L FLLT limits are close to being breached, discussions are held at Management level. As a result, either a business case is made for a change in limits (temporarily or permanently) to accommodate higher risk exposure or the Bank's business plan set out in SIP is adjusted to bring its back in compliance with the existing P&L FLTT limits. This approach ensures that business strategy decisions are taken with full awareness and understanding of the associated risks, and the implications for future risk profile of the Bank are transparently documented.

7.6 Recognising that taking market risk in its Banking activities is central to the pursuit of its mandate and mission, no further limits are imposed on the level of market risk in Banking activities. The overall amount of market and credit risk in the Banking portfolio is instead controlled through capital and leverage risk parameters set out in section 5 above, with all other types of financial risks tightly constrained to maximise headroom available for the core activities.

Banking debt and Treasury book

7.7 The Bank seeks to maintain very low residual market risk related to its Banking loan and guarantee transactions, as well as to Treasury assets and the Bank's liabilities. This is achieved, among others, by hedging foreign exchange and interest rate risks. The limits on the maximum amount of market risk accepted in this context are set out in the Treasury Authority and Liquidity Policy approved by the Board.

7.8 The maximum amount of residual market risk, measured through expected shortfall (eVaR) at one day horizon and 95% confidence interval, is set at €60 million overall and €10 million excluding basis risk. The difference between these two levels is mainly to facilitate sourcing of local currency for Banking operations through cross-currency swaps.

8. Model Risk Appetite

8.1 The Bank utilises a wide range of models to measure and manage its financial risks. These models give rise to model risk. Model risk is the potential for financial loss or other adverse impact that an institution may incur, as a consequence of decisions that are principally based on the output of models, due to errors in the development, implementation or use of such models.

8.2 Model risk can lead to financial loss, poor business and strategic decisions, or damage to reputation. Model risk occurs primarily for two reasons: (i) a model may have fundamental errors and produce inaccurate outputs when viewed against its design objective and intended business uses; and (ii) a model may be used incorrectly or inappropriately or there may be a misunderstanding about its limitations and assumptions. Model risk increases with greater model complexity, higher uncertainty about inputs and assumptions, broader extent of use, and larger potential impact.

8.3 The Bank puts in place risk based controls on inputs, assumptions and modelling techniques. For models critical to financial reporting, risk compliance or investment decisions, such controls typically involve review by an independent second line of defence team within Risk Management.

8.4 At the same time, the Bank recognises that, in addition to the usual modelling challenges, models supporting its core Banking activity are exposed to acute uncertainty about their inputs and assumptions, exacerbated by its focus on frontier and emerging markets where reliable data remains scarce and comparators are not straightforward to select.

8.5 As a consequence, the Bank has an overall moderate model risk appetite, provided that data and model limitations are understood by model users and decision makers. The Bank's model risk control framework is risk based, with the level of controls depending on the criticality of the models.

8.6 The Model Risk Management Framework: Key Principles is the overarching document describing the Bank's approach to identifying and managing model risk across its business activities. It sets out the types of models used at the Bank, as well as defining the risk appetite and control processes used in managing model risk.

9. Climate Risk Appetite

9.1 The Bank has an overarching ambition to manage its exposure to clients with businesses that emit material harmful emissions and to expand its financing activities in areas that encourage transition to greener business models, in particular supporting the pathways and commitments made by the governments of its Countries of Operation and individual clients, to achieve net zero emissions. The Bank also intends to expand its lending in areas that strengthen resilience of its clients to the effects of climate change.

9.2 Specifically, the Bank has committed to raise the share of total annual investments that meet its Green Economy Transition criteria, from 40% to 50% by 2025 and in addition that its activities will be aligned with the goals of the Paris Agreement by 2023.

9.3 As part of this strategy, the Bank has ended its interest in new investments in upstream Oil and Gas exploration and extraction, which matches its earlier decision to desist from financing coal extraction activities.

9.4 As an early signatory to the TCFD[1] initiative, the Bank is building its methodologies and capabilities to quantify its Climate Credit Risk associated with potential financial losses from exposures to Physical Climate risks (e.g. flood, fire, drought etc) as well as Carbon Transition risks (e.g. coal prohibition, carbon credit pricing, aviation taxes etc).

9.5 Climate Reputational Risk, triggered by the Bank's exposures and engagement with carbon-intensive sectors (e.g. coal production, coal fired electricity generation, upstream oil and gas exploration and production) will continue to be analysed and monitored.

9.6 The Bank anticipates that in line with industry developments and expectations, these methodologies, once rigorously tested, will in the future, help define its risk appetite in a quantitative manner. This will facilitate integration and calibration within the concentration framework.

10. Operational and Reputational Risk Appetite

Operational risk

10.1 The Bank's Operational Risk Appetite aims to articulate the aggregate level and types of operational risk that, over a certain time horizon, the Bank is willing to accept in its business activities in order to achieve its business objectives.

[1] Task Force on Climate-Related Financial Disclosures

10.2 Operational Risk Appetite is embedded through the Operational Risk Management Policy and operational risk management framework including the definition of key indicators, policies and risk limits, as well as the Bank's procedures and controls, which guide its day-to-day operations.

10.3 Reputational risk is inherent in all of the Bank's activities. It can also arise as a second order impact from operational risk incidents. Reputational risk appetite is therefore closely linked to the accepted level of operational risk.

10.4 Alongside Reputational Risk, the Bank identifies and manages 11 interrelated operational risks including categories:

- Business Resilience Risk: risk of disruption to the Bank's activities and operations caused by unavailability of systems, workforce or workplace;
- Change Management Risk: potential of negative impact from change projects and that ineffective project implementation could lead to sub-optimal solution;
- Fraud and Conduct Risk: risk of inappropriate conduct or actions by employees and/or third parties that defraud, misappropriate property or circumvent regulations, law or the Bank's policies or procedures, or which (in the case of third parties) gives rise to unacceptable integrity risks for the Bank;
- Human Resources and Skills Risk: risk that insufficient level of staff or failure to attract adequately skilled employees leads to sub-optimal performance;
- Information Security Risk: risk that confidentiality, integrity, accuracy and/or availability of a given information asset or system becomes compromised;
- Legal Risk: risk of non-compliance with legal obligations under applicable laws or contract, or the lack of enforceability of contractually agreed terms, as well as any other litigation, in each case with a revenue or contingent liability impact and/or material impact on the Bank's reputation;
- Physical Security and Health and Safety Risk: threats to staff health and safety, as well as to assets and infrastructure;
- Process Risk: risk of failure of key business processes;
- Product Risk: risk arising due to product complexity, as well as choice of products that prove unsuitable or do not meet performance objectives;
- Technology Risk: threat that technology systems and support become inadequate or fail to adapt to changing requirements;
- Vendor / Third Party Risk: risks related to the use of service providers and suppliers that could result in business disruption, misuse of data, or have adverse impact on business performance.

10.5 All business functions consider a balanced approach to their risks and controls, employ sound risk management principles, transparent decision-making, and effective communication to prioritise risk. In case a residual risk is assessed to be outside the

Bank's risk appetite, where appropriate, additional risk reducing actions are undertaken including further remediating risks. Where the Bank has discretion, it is willing to assume more risk to remain agile in meeting the challenges of an evolving business, political and banking landscape.

Reputational risk

10.6 Reputational risk constitutes an important aspect of operational risk. The Bank's reputation is derived from the collective confidence and respect that its stakeholders, Countries of Operation and the communities in which it operates have in and for the Bank and its ability to achieve its mission.

10.7 The Bank's reputation provides a robust ethical and professional platform that is critical to its ability to engage in policy dialogue and the raising of governance standards in countries of operation.

10.8 The Bank's status as an international financial institution does not safeguard its reputation. Its reputation could be affected by a wide range of incidents that (in the absence of mitigating steps) can have a relatively high probability of occurrence and, despite much of their impact being small scale, they could collectively erode confidence.

10.9 The Bank seeks to protect its reputation and minimise reputational risk by avoiding situations that could substantially weaken stakeholders' confidence in it, its Board or Management, or undermine its ongoing primary mission as set out in the AEB.

10.10 Reputational risk is the risk that the Bank's stakeholders, its Countries of Operation and/or the communities in which it operates, lose confidence in and respect for the EBRD and its ability to achieve its mission, resulting in an adverse effect on the Bank's ability to carry out its mandate in accordance with the AEB or on its ability to maintain existing, or establish new, business relationships and/or access to funding. Reputational Risk incidents may arise because the EBRD and / or its clients, or operations, have not: observed high standards of integrity and ethical conduct; acted with honesty and propriety; complied with EBRD's environmental and social standards; or applied sound legal policies and practices.

10.11 The Bank's key policies to protect its reputation are: the Codes of Conduct for EBRD Personnel and for Officials of the Board of Directors, the Integrity Risks Policy and Terms of Reference for the Office of the Chief Compliance Officer; Procurement Policies and Rules; Environmental and Social Policy; as well as Domiciliation Policy, Whistleblowing Policy, Enforcement Policy and Procedures, Operational Risk Management Policy.

Operational Risk Management and Mitigation

10.12 Faced with a high risk of operational risk incidents that could damage the Bank’s reputation, and given its low residual reputational risk appetite, the Bank requires the following:

Its Board, based on Management’s recommendation shall:

- Adopt appropriate standards of corporate governance, integrity and transparency;
- Approve Bank projects that are consistent with the Bank's reputational risk appetite; and
- Appoint suitably qualified and respected external auditors and provide them with an appropriate remit to supply an external independent opinion of the financial soundness and robustness of the control environment.

Management shall:

- Articulate the values and behaviours that are expected to be adhered to by employees, consultants, clients and suppliers to protect EBRD’s reputation.
- Establish appropriate standards for: (i) client integrity; (ii) product appropriateness; (iii) environmental, social and ethical responsibility; (iv) procurement; (v) information security & personal data protection and; (vi) compliance with relevant international standards that would serve to protect EBRD’s reputation.
- Strive to maintain professional and reputable business conduct across the Bank and its operations by requiring reliability, efficiency of delivery, integrity, honesty and transparency. This includes, in particular, identification and appropriate mitigation of operational risks across the Bank.
- Commit to the delivery of training involving technical competence, ethical conduct and the development of strong supervisory skills, to drive the culture that represents the required values and behaviours.
- Maintain and enable an adequately resourced, suitably skilled and appropriately independent set of control functions.
- Establish performance measurement and balanced incentives that: (i) encourage and reward good outcomes (behaviour and achievement of results); (ii) reinforce accountability; and (iii) encourage pro-active transparency and escalation of problems and mistakes.
- Take action to address institutional deficiencies that may adversely impact the Bank's reputation.

Residual operational risk appetite

10.13 In the short term, the Bank accepts material intrinsic operational risk across number of risk categories set out in paragraph 9.4 above. These risks relate to the ongoing multiyear programme of significant change, which includes preparation and relocation to new headquarters, migration of the data centre, and significant upgrade of several IT systems and tools. These investments facilitate a necessary transformation of the organisation and help build lasting foundation for its future activities. They affect, in particular, the level of risk in the Change Management, Business Resilience, Process, Technology and Vendor/Third Party categories. Material investment and budget has been and will be deployed to execute this transformation and reduce residual operational risk to within tolerance.

10.14 The Bank sets its long term Risk Appetite for suffering damage to its reputation as low.

Annex 1: Glossary of Terms

Bank-wide Stress Test: Statistical top-down stress test covering all elements of the Bank's balance sheet and activity. It is based on statistical models of the Bank's assets and liabilities and informed by historical trends and patterns in the underlying data, including default experience and market movements.

Capital: Members' equity attributable to equity holders as defined by the International Financial Reporting Standards and reported in the Balance Sheet of the Bank. Capital consists of paid-in capital, reserves and retained earnings.

Cyclical Downturn: A hypothetical adverse stress test scenario equivalent to the worst year in a typical 7 year business cycle. In statistical terms, it is likely to occur in any year with a likelihood of 1:7.

Extreme Stress: A hypothetical adverse stress test scenario equivalent to a substantial widespread global depression. In statistical terms, it is likely to occur in any year with a likelihood of 1:100.

Financial Loss Tolerance Threshold: The maximum amount of losses, as measured by net earning under IFRS accounting standards, and the maximum increase in capital utilisation, as measured by the Capital Adequacy Policy, that the organisation is willing to tolerate under a given Bank-wide Stress Test scenario.

Net Earnings: Net loss or profit for the year arising from continuing operations as defined by the International Financial Reporting Standards and reported in the Income Statement of the Bank. Net Earnings are measured before any income transfers approved by the Board of Governors.

Risk Appetite: The aggregate level and types of risk that an institution is willing to accept, or to avoid, in order to achieve its business objectives. It normally covers liquidity and reputation risks, as well as risks to capital and profitability.

Risk Appetite Statement: The articulation in written form of Risk Appetite. It normally includes qualitative statements and quantitative measures expressed relative to earnings, capital, risk measures, liquidity and other relevant measures as appropriate.

Severe Stress: A hypothetical adverse stress test scenario equivalent to a material non-systemic crisis. In statistical terms, it is likely to occur in any year with a likelihood of 1:25.

Annex 2: Risk Taxonomy and Risk Appetite related metrics and controls

Risk type:
Capital, leverage and liquidity risk

Definition:
Capital and leverage risks result from the Bank's vulnerability to higher risk investments or excessive leverage which may require unintended corrective measures to its business and/or capital plan such as cutting of new business, distressed selling of assets or issuance of additional capital to remain solvent. Liquidity risk is defined as the risk of not having sufficient financial resources available to meet payment obligations as they fall due, or access these resources only at excessive costs.

Risk appetite articulation:
Preserve capital and liquidity structure consistent with AAA credit rating as well as ability to meet commitments under normal and stressed economic environment.

Control area	Purpose	Authority	Metric or assessment basis	Limit, threshold definition or acceptance criteria	Policy reference
Capital	Preserve capital structure consistent with AAA credit rating	Board	CAP utilisation, RC in % AC	Prudential limit	Capital Adequacy Policy
		Management	Stressed CAP utilisation RC in % of AC under Downturn and Severe	Capital FLTT	Risk Appetite Statement
Leverage	Avoid excessive growth	Board	OA at cost net of specific provisions in % of Statutory Capital Base	Prudential limit	Strategic and Capital Framework
Liquidity risk short term	Ensure sufficient cash inflows from maturing assets to meet cash outflows without resource to market or asset sale	Management	Cash inflows in % of cash outflows for a 30 and 90 day time horizon	Standard minimum ratio	Treasury Authority and Liquidity Policy & Procedures
Liquidity risk medium term	Meet medium term cash requirements with limited recourse to funding markets	Management	Net treasury liquid assets in % of 2 year net cash outflow	Standard minimum ratio	Treasury Authority and Liquidity Policy & Procedures

Liquidity risk one year	Proxy S&P ratio	Management	Liquid assets in % of 12 months net cash outflow plus 50% undrawn commitments	Standard minimum ratio	Treasury Authority and Liquidity Policy & Procedures
	Preserve sufficient liquidity under stressed economic conditions	Management	Stressed net cash out flow relative to net treasury liquid assets under Extreme scenario	Minimum survival period	Treasury Authority and Liquidity Policy & Procedures

Risk type: Banking Credit Risk					
Definition: Banking Credit Risk is defined as the potential loss to a portfolio that could result from either the default of a counterparty or the deterioration of its creditworthiness. Credit risk can be driven by client-specific risk factors, systemic risk factors such as related to the economic sector or country, as well as credit concentrations.					
Risk Appetite articulation: The Bank is willing to accept higher levels of credit risk from engaging with the private and public sector of less developed countries in pursuit of its strategic objectives. The Bank protects itself from undue idiosyncratic and systemic credit risk by careful structuring of deals and by adopting a variety of limits.					
Control area	**Purpose**	**Authority**	**Metric or assessment basis**	**Limit, threshold definition or acceptance criteria**	**Policy reference**
Single transaction non-sovereign and sovereign exposure limit	Balance strategic objectives with risk considerations	Board	Nominal investment amount	Limit applies to the overall investment amount for each transaction.	Banking Credit Process
		Management	Nominal investment (on transactions with delegated authority from the Board)		
Single obligor non-sovereign and sovereign concentration risk	Ensure Bank is not overly concentrated to large exposures	Board	Nominal and RC based Nominal: Portfolio amount in % of AC with Portfolio incl. FV for equity RC based: RC in % of AC	Prudential limit: Limit applied to non-sovereign exposures at different client hierarchy levels.	Capital Adequacy Policy
		Management	Nominal amount: Portfolio incl. FV for equity	Limit depends on PD rating. Applied at different client hierarchy levels.	Banking Credit Concentration Limit Framework
Country concentration risk	Ensure Bank is not overly exposed to any single country	Board	RC based: RC in % of AC	Prudential limit: Limit set depending on size of country measured in GDP	Capital adequacy policy

		Management	RC based: RC in % of AC	Standard limit	Banking Credit Concentration Limit Framework

Risk type:
Treasury Credit Risk

Definition:
Treasury Credit Risk arises from the potential default of a counterparty to the Bank's Treasury investments in deposits or bonds. It also comprises counterparty risk resulting from transactions with bilateral risk of loss including OTC derivatives, repurchase and reverse repurchase agreements and long settlement transactions.

Risk appetite articulation:
The Bank seeks to maintain low levels of credit risk associated with its liquid asset portfolio. A high portfolio quality is maintained through a set of individual and portfolio limits.

Control area	**Purpose**	**Authority**	**Metric or assessment basis**	**Limit, threshold definition or acceptance criteria**	**Policy reference**
Counterparty eligibility criteria and single exposure concentrations	Limit risk concentrations to individual counterparties, countries and sovereigns	Management	PFE credit exposure	Limits are set depending on tenor and PD rating	Treasury Authority and Liquidity Policy & Procedures
Portfolio risk	Limit overall and sub portfolio credit risk	Management	Default VaR for overall liquid asset portfolio, measured at a 99.99% confidence level and 1 day time horizon Peak PFE for various sub portfolios (ABS, Corporate, etc.) Nominal amount for repo/reverse repo and long settlement transactions (non-delivery vs payment)	Default VaR limit set in % of AC Standard limits for sub-portfolio PFE Limits depending on internal PD rating	Treasury Authority and Liquidity Policy & Procedures

Risk type:
Market risk – Banking and Treasury book

Definition: Market risk is defined as the potential for loss due to adverse changes in financial market rates or prices. It can arise from changes in interest and FX rates, credit spreads, as well as equity and commodity prices.					
Risk appetite articulation: The Bank allows only for minimal residual FX and interest rate risk from overall Banking and Treasury operations. Treasury hedges mismatches arising from assets and liabilities in terms of tenor, currency and interest rates by derivative instruments. The Bank is willing to accept equity risk in the Banking book in pursuit of its strategic objectives.					
Control area	**Purpose**	**Authority**	**Metric or assessment basis**	**Limit, threshold definition or acceptance criteria**	**Policy reference**
FX and interest rate risk in Banking and Treasury book (assets and liabilities)	Ensure market risk excluding equity risk is kept to a minimum	Management	EVaR measured at 95% confidence level and 1 day time horizon	Limits defined overall and for a variety of risk factors such as basis risk and FX	Treasury Authority and Liquidity Policy & Procedures
Equity risk Banking book	Constrain volatility in financial results	Management	1 year stressed P&L under Downturn and Severe calculated based on annual Bank-wide stress test	P&L FLTT for Downturn and Severe stress scenario	Risk Appetite Statement

Risk type:
Operational including reputational risk

Definition:
Operational Risk is the risk that the Bank's people, processes, systems, or external events hinder the ability to meet its objectives. This risk is a function of internal controls, employee conduct, process efficiency, third-party oversight, physical security, and business continuity planning. Operational risk also includes the breakdown of processes to comply with rules and policies, as well as second order reputational risk.

Reputational risk is the risk that the Bank's stakeholders, its Countries of Operation and/or the communities in which it operates, lose confidence and respect for the EBRD and its ability to achieve its mission, resulting in an adverse effect on the Bank's ability to carry out its mandate in accordance with the AEB or on its ability to maintain existing, or establish new, business relationships and/or access to funding.

Risk appetite articulation:
The Bank has a growth strategy over the next 12 months and therefore is prepared to accept some operational risk exposure related to taking on new products, services, technology and outsourcing to ensure targets and benefits are achieved. All functions must continue to consider a balanced approach to their risks and controls, employ sound risk management principles, transparent decision-making, and effective communication to prioritise risk. However, the Bank recognises that even the best processes will not always prevent Bank from experiencing problems or failing.

The Bank sets its Risk Appetite for suffering damage to its reputation as low.

Control area	**Purpose**	**Authority**	**Metric or assessment basis**	**Limit, threshold definition or acceptance criteria**	**Policy reference**
Fraud and Conduct – client and employee related integrity risk	Protect reputation of the Bank by ensuring high standards of integrity in all its business operations	Board	Information provided on clients, sponsors or staff.	Check of client and sponsor information against integrity procedures and guidelines to assess potential integrity risks. Higher risks are subjected to increased levels of scrutiny. Rejection of projects that expose the Bank to unacceptable integrity risk. Personal conduct related risks are addressed by establishing, communicating, monitoring, and implementing a clear set of rules regarding the required ethical conduct of Bank Personnel and Board Officials, and by taking appropriate	Code of Conduct for Bank Personnel Integrity Risk Policy Operational Risk Policy Enforcement Policy and Procedures Conduct and Disciplinary Rules and Procedures Whistleblowing Policy

				corrective action in the event of a breach.	
Fraud and Conduct - environmental and social risks	Protect reputation of the Bank from investments in environmentally or socially harmful projects	Board	Information provided by clients on potential environmental and social impacts of projects on stakeholders.	Check of information against a set of performance requirements for key areas of environmental and social sustainability that projects are expected to meet. Remedial action plan to be implemented by clients in case of failure to meet requirements. Rejection of projects that expose the Bank to unacceptable environmental and social risks.	Environmental and Social Policy Operational Risk Policy
Fraud and Conduct - procurement	Protect reputation of the Bank from unfair, non-transparent or discriminatory Bank or client procurement practices	Board	Information on details of transaction and/or procurement strategy	Check against a variety of acceptance criteria. For public sector operations, contracts shall be procured following Open Tendering, if their value is estimated to equal, or exceed €140,000 for goods and services and €5.35 million for works and supply and installation contracts. Procurement of consultant services must follow competitive selection for costs of €75,000 or more.	Procurement Policy Operational Risk Policy
Legal risk	Protect the Bank from financial and reputational damage resulting from violation of legal requirements	Board	Legally relevant information on clients, projects, products and policy decisions	Control system that promotes compliance with legal requirements, and uses internal and external legal counsel as both a safeguard against unlawful actions and a resource for informed decision-making.	AEB and other policies guiding the Bank's operations
Business Resilience Risk	Protect the Bank from disruption to its activities and operations	Board			

	caused by unavailability of systems, workforce or workplace		Completeness and coverage of risk and control assessments. Effectiveness of the control environment. Number of Issue resolution overdue Number of internal incidents. Audit findings.	Variety of limits and acceptance criteria	Operational Risk Management Policy Informational Security Policy Code of Conduct Integrity Risk Policy Environmental and Social Policy Procurement Policy AEB and other Policies guiding the Bank's operations
Change Management Risk	Protect the Bank from potential of negative impact from change projects and that ineffective project implementation could lead to sub-optimal solution	Board			
Human Resources and Skills Risk	Protect the Bank from sub-optimal performance caused by insufficient level of staff or failure to attract adequately skilled employees	Board			
Information Security Risk	Protect the Bank from compromising confidentiality, integrity, accuracy and/or availability of information assets or systems	Board			
Physical Security and Health and Safety Risk	Protect the Bank from adverse impact due to threats to staff health and safety, as well as to assets and infrastructure	Board			
Process Risk	Protect the Bank from failure of key business processes	Board			
Product Risk	Protect the Bank from risk arising due to product complexity, as well as choice of products that prove unsuitable or do not meet performance objectives	Board			
Technology Risk	Protect the Bank from threat that technology systems and support	Board			

	become inadequate or fail to adapt to changing requirements				
Vendor / Third Party Risk	Protect the Bank from risks related to the use of service providers and suppliers that could result in business disruption, misuse of data, or have adverse impact on business performance	Board			

Risk type: Pension risk					
Definition: Pension risk is defined as the risk of having to meet an actuarially assed shortfall in the Bank’s defined benefit pension plan					
Risk appetite articulation: The Bank is seeking a balanced investment strategy which minimises the risk of an overall reduction in the value of the FSP assets and maximises the opportunity for gains across the whole investment portfolio.					
Control area	**Purpose**	**Authority**	**Metric or assessment basis**	**Limit, threshold definition or acceptance criteria**	**Policy reference**
Investment risk	Limit the risk of a fall in asset values not matched by similar falls in the value of the plan’s liabilities	Management	Variety of sensitivity metrics	Review performance of all of the funds against their benchmarks.	Retirement Plan Rules