



Department of Finance
Canada

Ministère des Finances
Canada

Canada at the European Bank for Reconstruction and Development 2012

Report on Operations Under
the European Bank for Reconstruction
and Development Agreement Act

Canada

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Cette publication est également disponible en français.

Cat. No.: F1-29/2012E-PDF



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Foreword

by the Minister of Finance
and Canadian Governor at the EBRD

I am pleased to present *Canada at the European Bank for Reconstruction and Development 2012: Report on Operations Under the European Bank for Reconstruction and Development Agreement Act*. This report provides an overview of what was an eventful year for the European Bank for Reconstruction and Development (EBRD) and Canada's relationship with this important institution.



In producing this report, the Government is providing Members of Parliament and all Canadians with an account of Canada's role at the EBRD. The Government continues to focus on ensuring institutional effectiveness and promoting good governance and accountability.

This commitment was demonstrated by our follow-through on Canada's objectives for 2012, as outlined in this report. The report also lays out the Government's primary objectives for 2013:

- Prioritize resources to the areas of greatest need, including to the countries of the Southern and Eastern Mediterranean (SEMED), and follow through on the Bank's target for EU-7 graduation.
- Ensure that EBRD financing is prioritized to countries of operations that have demonstrated an ongoing commitment to multiparty democracy, rule of law and human rights.

In 2012, Canada was pleased to welcome two of the newest members of the EBRD—Jordan and Tunisia—into our constituency. The Director for Canada now represents Morocco, Jordan and Tunisia at the EBRD Board of Directors as all three countries move towards the goal of full country of operations status at the EBRD. We look forward to strengthening our relationship with these countries throughout this process and beyond.

Canada was also pleased to see the Bank select a new President at the 2012 EBRD Annual Meeting in an open, transparent and competitive selection process. Canada welcomes the new President, Sir Suma Chakrabarti, and looks forward to working with him to strengthen the EBRD's governance and effectiveness.

The events of the past several years have raised the international profile of the EBRD considerably, bringing with it both challenges and opportunities. As economic uncertainty continues to cast a shadow over the region's economic recovery, it is clear that the EBRD has a central role in both its existing countries of operations and the new SEMED region. As a major shareholder and member of the Board of Governors of the EBRD, Canada actively supports the Bank's mission in the period ahead.

The Honourable James M. Flaherty, P.C., M.P.
Minister of Finance



Overview

The European Bank for Reconstruction and Development (the EBRD or the Bank), created in 1991, is a unique, project-oriented institution that focuses on developing the private sector and strengthening market-supporting institutions in Central and Southeastern Europe, the successor states of the former Soviet Union, Mongolia and Turkey. In 2011 the EBRD Board of Governors voted to expand the EBRD's geographic scope to include the Southern and Eastern Mediterranean (SEMED) region, which encompasses all countries with a shoreline on the southern or eastern Mediterranean Sea, as well as Jordan. In pursuing its mission, the EBRD operates only in countries that demonstrate a commitment to the fundamental principles of multiparty democracy, pluralism and market economics.¹

The Bank's operations are guided by four core principles: transition impact, additionality, sound banking, and environmental and social sustainability. These principles mean that the EBRD's activities should foster transition towards open, democratic societies through the development of entrepreneurship and the private sector. The EBRD should also catalyze additional flows of private sector financing while adhering to principles of good financial governance and ensuring the effective use of capital. Finally, the Bank's operations should be socially and environmentally sustainable. For further information see the section entitled "Background on the EBRD."

As a founding member and the eighth largest shareholder of the Bank, Canada actively contributes to the development of Bank policies and provides oversight of its financial activities. It does so primarily through its seat on both the Board of Governors and the Board of Directors (representing a constituency that includes Morocco and, as of 2012, Jordan and Tunisia) and its participation in the work of various committees. Canada's objectives for the Bank are informed by a commitment to the Bank's underlying mandate, Canadian government policy goals and input from civil society. These objectives are described in the sections entitled "Progress Made on Canada's Objectives for 2012" and "Canada's Objectives for 2013."

Canada has a vested interest in seeing that the EBRD remains a strong, effective and accountable institution. The development of market-oriented economies with strong democratic institutions is a critical component to peace, stability and economic growth in the region. Our membership in and financial support for the EBRD provide Canada with the opportunity to advance the transition process in the Bank's region of operations. For an overview of developments in the EBRD's region of operations, see Annex 5.

Key developments over the course of 2012 included the EBRD's first investment projects in the new SEMED region, the election of a new President, and Kosovo joining the EBRD. The EBRD also continued its recent trend and reported a strong financial performance in 2012. More details are provided in the following section.

¹ Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development. Where countries do not demonstrate a commitment to these principles, the Bank limits its activities accordingly.



What Happened in 2012

Expansion of the EBRD's Mandate

In 2012, the EBRD received the support of its Board of Governors to enlarge its area of operations to include the SEMED region. This change was made in concert with the G-8 Deauville Partnership, a multilateral initiative aimed at supporting the democratic and economic transition in the Arab Spring countries. The Declaration of the G-8 on the Arab Spring in May 2011 called for the “extension of the geographic scope of the EBRD’s mandate, in order to support the transition in countries of the region which embrace multiparty democracy, pluralism and market economies.”

The EBRD has moved quickly to mobilize interim financing for projects in the region. The EBRD is managing Special Funds to begin investment operations in the new region. The Special Funds consist of net income transferred from the EBRD’s reserves, as well as funds from the European Union (EU) for technical cooperation. The first projects in Morocco, Jordan and Tunisia were approved by the Board in October 2012, while Egypt’s first project was approved in December 2012. Business volume in the new region in 2012 was approximately €181 million.

Election of the New EBRD President

The term of incumbent President Thomas Mirow expired in June 2012, and the Board of Governors met at the Annual Meeting in May to elect the EBRD’s next President. In the past, elections had effectively been decided in advance by shareholders with a majority of the voting share. For the first time in the EBRD’s history, the outcome of the election was not known in advance. There were five candidates from France, Germany, Poland, Serbia and the United Kingdom. Sir Suma Chakrabarti, a UK citizen, was elected to serve the next four-year term as President of the EBRD.

Membership of Kosovo

Kosovo has considered becoming a member of the EBRD since achieving independence in 2008. Due to its geographic location and the fact that Kosovo faces many of the same transition challenges as its neighbours, country of operations status in the EBRD offers clear benefits. Following a formal application earlier in the year, Kosovo secured a sufficient number of votes in November 2012 to join the Bank as a country of operations. Canada was among the countries that supported Kosovo’s membership. Kosovo completed its internal procedures and finalized its subscription in December, thereby becoming the 66th member of the EBRD.

Canada’s EBRD Constituency

In 2012, Canada was pleased to welcome two of the newest members of the EBRD—Jordan and Tunisia—into our constituency. The Director for Canada now represents Morocco, Jordan and Tunisia at the EBRD Board of Directors.



The EBRD's Financial Performance

The EBRD maintained a high level of business activity in its region of operations throughout the year. Commitments totalled €8.9 billion in 2012, in line with projections, while disbursements reached €6.0 billion (€6.7 billion in 2011). The EBRD's projects attracted some €17.4 billion in additional financing—of which €1.2 billion was from syndicated loans (€1.0 billion in 2011).

The EBRD returned to healthy profits of just over €1.0 billion for 2012. This was significantly higher than in 2011, primarily due to changes in unrealized equity fair values (which registered a gain of €57 million in 2012 compared to a loss of €586 million in 2011). Operational and financial highlights are summarized in Table 1.

Table 1
EBRD Operational and Financial Indicators, 2008–2012
(€ million)

	2012	2011	2010	2009	2008
Number of projects	393	380	386	311	302
EBRD commitments	8,920	9,051	9,000	7,861	5,087
Resources mobilized	17,372	20,802	13,174	10,353	8,354
Total project value	24,871	29,479	22,039	18,087	12,889
Realized profit before impairment	1,006	839	927	849	849
Net profit/loss for the year before transfers of net income	1,020	173	1,377	-746	-602
Paid-in capital	6,202	6,199	6,197	5,198	5,198
Reserves and retained earnings	7,808	6,974	6,780	6,317	6,552
Total members' equity	14,010	13,173	12,977	11,515	11,750

Overall, the Bank's strong capitalization, coupled with low levels of non-performing loans, low leverage and ample liquidity buffers, indicate that the EBRD continues to be in a strong position to carry out its mandate in the medium term. The Bank continues to be rated AAA or equivalent with a stable outlook by all three major credit rating agencies (Standard & Poor's, Moody's Investors Service and Fitch Ratings). The EBRD's year-end financial statements are available on its website (www.ebrd.com/pages/research/publications/flagships/financial.shtml).



Canada and the EBRD

Canada's relationship with the EBRD is governed by the European Bank for Reconstruction and Development Agreement Act. The Act outlines Canada's responsibilities with respect to the EBRD and sets out that the Minister of Finance shall lay before Parliament by March 31 of each year (or, if the House is not sitting, on any of the thirty days thereafter that it is sitting) a report of operations under the Act for the previous calendar year.

Canada's Contribution to Ordinary Capital Resources

Canada is the eighth largest shareholder of the EBRD, with its shares representing 3.4 per cent of the institution's capital. This amounts to €1.02 billion of the Bank's capital, €212 million of which is paid-in capital, with the remaining shares being callable capital.

Oversight and Representation

The principal responsibility for oversight of the EBRD's key activities resides with the Department of Finance. The Department of Finance coordinates Canadian policy advice and manages Canada's strategic interests at the EBRD in consultation with Foreign Affairs and International Trade Canada.

Canada's representation at the EBRD—The Honourable James M. Flaherty, Minister of Finance, is the Canadian Governor and Mr. Morris Rosenberg, Deputy Minister of Foreign Affairs, is the Alternate Governor. In 2012 Canada's resident representative on the EBRD Board of Directors was Ms. Suzanne Hurtubise. Ms. Hurtubise was succeeded by Ms. Claire Dansereau on January 7, 2013. The Honorable Ted Menzies, Minister of State (Finance), represented Canada as the Temporary Alternate Governor at the 2012 EBRD Annual Meeting in May in London, UK.

Canada's constituency at the EBRD—In 2012, Canada was pleased to welcome two of the newest members of the EBRD—Jordan and Tunisia—into our constituency. The Director for Canada now represents Morocco, Jordan and Tunisia at the EBRD Board of Directors.

Canadian staff at the EBRD—Canadians are well represented on EBRD staff. At the end of 2012, there were 35 Canadians on the staff of the EBRD, representing 2.12 per cent of total positions. Canadians fill the senior positions of Deputy Chief Compliance Officer, Director of Planning and Portfolio for Financial Institutions, and Director of the Early Transition Countries Initiative.

Benefits of Membership

Canada's membership in the EBRD, and its active participation in the discussion of policy and operational issues, is an important means to help shape economic and social development in the EBRD's countries of operations. Canada strongly supports the overriding objective of developing a strong private sector in its countries of operations by mobilizing financing for projects with a high transition impact and by providing advice and technical assistance to businesses and governments. The Bank provides Canada with a vehicle to contribute to development in transition countries that are not currently part of our bilateral development assistance programs.



Canada's engagement helps to raise awareness among Canadian companies of opportunities presented by the EBRD. The Canadian Trade Commissioner Service regularly liaises with the EBRD's resident offices, which allows it to provide intelligence on project opportunities to Canadian companies. In addition, trade commissioners work with EBRD officials to promote transparency and rule of law in the EBRD's countries of operations, often advocating on behalf of Canadian investors active in markets in the region.

Canadian companies can seek financing for projects undertaken in the Bank's countries of operations. The Bank often relies on the procurement of goods and services from the private sector to implement transition projects. Canadian consultants were awarded contracts valued at €1,022,701 in 2012, down slightly from €1,047,941 in 2011. While no EBRD projects were signed with Canadian companies in 2012, a Canadian financial firm provided €20.9 million in co-financing for a project.

Canada's Contribution to Cooperation and Special Funds

In addition to a loan or equity investment, the EBRD often supports its clients with advice on project preparation and effective implementation. This advice is often paid for out of Technical Cooperation Funds, which are set up by donor countries and international institutions and are managed by the Bank, or out of the Shareholder Special Fund. These funds mobilize investment capital and expertise in the EBRD's countries of operations by giving local businesses access to consultant experts. The consultants assist in the preparation of projects and strengthen local management know-how. They also develop environmental strategies and work to improve the legal framework in which businesses operate.

The Canadian International Development Agency (CIDA) has been a major contributor to the EBRD's Technical Cooperation Funds, contributing about €40 million since the EBRD was established in 1991. Canada is also a donor to the following Cooperation and Special Funds:

Russia Small Business Fund (RSBF)—The RSBF was established in 1994 with the support of the G-7 countries and Switzerland to provide micro and small enterprises (MSEs) in Russia with financing to fit their particular requirements and to help strengthen the capacity of the Russian banking sector so that it can effectively lend to MSEs on a sustainable basis. The fund was established with a pledged contribution of US\$150 million from the EBRD and US\$141.7 million from donor countries, comprised of US\$71.0 million for co-investment and US\$70.7 million for technical cooperation programs. Canada's share of the initial contribution totalled US\$8.1 million.



Chernobyl Shelter Fund (CSF)—The main purpose of this fund, which was launched in 1995, is to secure the sarcophagus around the destroyed Unit IV nuclear reactor in Ukraine. The CSF finances the implementation of the Shelter Implementation Plan, which includes the construction of a permanent confinement facility, enhanced radiation monitoring, and general improvements to nuclear and worker safety. In 2011, following serious cost and schedule overruns, it was determined that an additional €740 million was required to sustain the CSF and the Nuclear Safety Account (NSA) project (see below). An international fundraising initiative secured commitments by donors to make up the shortfall, including an additional C\$30 million from Canada as announced by Prime Minister Stephen Harper in May 2011. This funding was fully disbursed in 2012 from Canada’s Global Partnership Program, which has been responsible for Canada’s contributions to the CSF and NSA since 2006. The EBRD has also contributed significantly to the CSF and NSA. Under the Shelter Implementation Plan, the permanent confinement facility is scheduled to be completed by October 2015 at an agreed cost of €935 million.

Nuclear Safety Account (NSA)—This account was established in 1993 to help address nuclear safety issues related to Soviet-designed reactors in Central and Eastern Europe. The NSA financed the decommissioning of all the undamaged Soviet-style reactors at Chernobyl following the 1986 accident, and it is now funding construction of an interim spent nuclear fuel storage facility and a liquid radioactive waste treatment facility. As with the CSF, the NSA has also experienced significant cost and schedule overruns and is being replenished as part of the fundraising effort noted above. C\$10 million of Canada’s most recent C\$30-million contribution was allocated to the NSA.

Northern Dimension Environmental Partnership (NDEP)—The NDEP was created in 2001 with a “Nuclear Window” component to fund the safe and secure management of the spent nuclear reactor fuel and other radioactive wastes generated by the dismantling of Russia’s northern submarine fleet. The NDEP’s focus on infrastructure was critically important as it fundamentally helped improve the dismantlement process (2002–2012) by securing spent nuclear fuel and radioactive material at various sites and increasing storage capacity. In 2004 Canada joined a number of other donors by contributing C\$32 million to the NDEP Nuclear Window through Canada’s Global Partnership Program.

Information on Canada’s bilateral assistance programs can be found in Annex 4.



Progress Made on Canada's Objectives for 2012

The Government of Canada is committed to promoting effective institutions, good governance and accountability both at home and in its relations with the international community. Canada's objectives at the EBRD for 2012 reflected this commitment.

Presented below is a summary of the progress made on the objectives identified in last year's report.

1. Support the EBRD's efforts to foster private sector development and inclusive economic growth in the Southern and Eastern Mediterranean (SEMED) region.

This objective included advocating for the appropriate and timely use of Cooperation Funds and Special Funds in the SEMED region, and encouraging strong collaboration with other international financial institutions operating in the region.

The EBRD has performed strongly on this front, while operating within the constraints posed by the Agreement Establishing the EBRD. Overall, 2012 saw the EBRD ramp up its operations in the new region in a timely fashion. The Bank deployed Cooperation Funds for 31 technical advisory and capacity-building projects valued at €6.2 million.²

Once the ratification threshold for amendments to Article 18 was reached in August 2012, the EBRD could officially begin using Special Funds for direct investments in countries granted "potential country of operations" status by the Board of Directors. Jordan, Morocco and Tunisia were granted this status in September 2012, followed by Egypt in December 2012. By the end of the year, 6 projects to be funded by Special Funds were approved in these countries, amounting to approximately €181 million. The EBRD's shareholders are in the process of ratifying amendments to Article 1 (which requires unanimity) to finalize the expansion.

Furthermore, in 2012 the EBRD signed a Memorandum of Understanding (MOU) with the Arab Monetary Fund. MOUs with the Islamic Development Bank and the African Development Bank had already been signed in 2011.

Canada was fully supportive of each of these steps throughout the year through its work in Board Committees and its voting at the Board of Directors. For instance, Canada welcomed Jordan and Tunisia into our constituency. Canada's Executive Director will therefore be facilitating the dialogue between the EBRD and these SEMED countries throughout the early stages of their new relationship. In addition, at the Annual Meeting in May 2012, Canada supported the Governors' vote to transfer €1 billion of the EBRD's net income to the Special Funds to ensure sufficient resources were available for project opportunities in the new region. Canada was also supportive of the EBRD's first projects in Jordan, Egypt, Morocco and Tunisia.

² Funding for the Cooperation Funds came from three main sources: the Cooperation Funds Account (funded from the EBRD's net income); the EBRD Multi-Donor Account; and the European Union Neighbourhood Investment Facility.



2. Support sustainable transition in the EBRD's countries of operations and the effective and appropriate use of shareholder capital.

This objective included advocating for a larger share of EBRD resources to be dedicated to the countries with the largest transition gaps, including through the graduation of the EU-7³ in the medium term. It also included encouraging EBRD leadership in three key areas: support for countries demonstrating a commitment to multiparty democracy and pluralism; continued progress in promoting the development of local currency capital markets; and implementation of a larger number of projects that support innovation in the real economy.

Throughout 2012 Canada used its position on the Board of Directors to reinforce the importance of the EBRD using its scarce resources for projects in countries with the greatest transition gaps. Generally, Canada has been pleased with the EBRD's performance on this front. The Bank's projects are increasingly focused "East and South": the number of projects signed in the Early Transition Countries (ETCs) remained high in 2012 at 118 (compared to 120 in 2011) and annual business volume in the ETCs increased by 5 per cent to just over €1.06 billion (compared to €1.01 billion in 2011).

However, a higher-than-expected proportion of business volume was concentrated in the advanced European countries, or the EU-7, in 2012 (14 per cent versus the 8 per cent target). This reflects, in part, the demand-driven nature of the EBRD's business and the slower-than-expected economic recovery in the EU-7 due to economic challenges in the euro area. Canada is concerned that by overshooting the target so significantly, the EBRD is helping to create an environment in which the EU-7 will be unlikely to follow through on their commitment to graduate from country of operations status in 2015. Over the past year, Canada has pushed for the updated country strategies of Estonia and Latvia—both part of the EU-7—to be designed as roadmaps that will lead those countries to the point of graduation in 2015.

The EBRD also continues to expand its Local Currency and Local Capital Market Development Initiative. In particular it participated in an assessment mission to Turkey, and it has organized and scheduled capital market assessment missions to the SEMED countries in cooperation with the Arab Monetary Fund and with participation from six international financial institutions. In 2012 transactions in local currency totalled €1.6 billion, which is the highest level ever at the EBRD. This brings the total local currency transactions to €7 billion.

Finally, Canada used its position on the Board and in Committees to encourage the Bank to find projects that foster innovation in the real economy. In this vein, the EBRD is expected to present a new Information and Communication Technologies sector strategy in early 2013.

³ Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia.



3. Promote appropriate governance and accountability structures at the EBRD.

This objective included advocating for EBRD leadership positions to be staffed through open, transparent and merit-based selection processes.

As noted in the section “What Happened in 2012,” the EBRD Board of Governors met in May 2012 to select a candidate to serve the next four-year term as EBRD President. In March 2012, during the nomination process, Minister Flaherty wrote a letter to the Chair of the EBRD Board of Governors, who is responsible for overseeing the nomination process, requesting that the process be fair, transparent and based on merit. He called for a process that would allow all Governors to participate directly in the selection of the next EBRD President.

Ultimately, due in part to pressure from shareholders like Canada, the EBRD conducted an open, transparent and competitive process in which five candidates from five member countries (France, Germany, Poland, Serbia and the United Kingdom) participated in the election at the EBRD Annual Meeting. The successful candidate—Sir Suma Chakrabarti of the United Kingdom—is the first EBRD President that is not a French or German national. This represents an important step towards ensuring that the EBRD’s senior leadership positions are selected based on merit, rather than nationality.

In addition, a new First Vice President, Banking was chosen in 2012 through an open, competitive and merit-based process.

Canada’s Objectives for 2013

As part of its ongoing leadership and oversight role at the EBRD, Canada supports the Bank in delivering on its core transition mandate as effectively and efficiently as possible. Canada also works to ensure the financial stability of the institution and that it follows through on commitments made as part of the fourth Capital Resources Review. As it undertakes this oversight role, Canada engages the EBRD through a number of different channels, including through active coordination with its Executive Director. In addition to this work, the following are Canada’s main objectives for the year ahead:

- 1. Prioritize resources to the areas of greatest need, including to the countries of the Southern and Eastern Mediterranean, and follow through on the Bank’s target for EU-7 graduation.**
- 2. Ensure that EBRD financing is prioritized to countries of operations that have demonstrated an ongoing commitment to multiparty democracy, rule of law and human rights.**



Background on the EBRD

Mandate and Role of the EBRD

The EBRD began its operations in 1991. Its aims are to foster the transition towards open, market-oriented economies in Central and Southeastern Europe, the successor states of the former Soviet Union, Mongolia and Turkey and to promote private and entrepreneurial initiative in those countries that are committed to the fundamental principles of multiparty democracy, pluralism and market economics.⁴ Where countries are not committed to these principles, the Bank develops a strategy for limited involvement. To deliver on its mandate, the Bank focuses its activities on assisting its 30 countries of operations in implementing economic reforms, taking into account the particular needs of countries at different stages in the transition process.

The Bank's overriding focus is the private sector, with a strong operational emphasis on enterprise restructuring, including the strengthening of financial institutions, and the development of the infrastructure needed to support the private sector. The EBRD's charter stipulates that not less than 60 per cent of its financing commitments should be directed either to private sector enterprises or to state-owned enterprises implementing a program to achieve private ownership and control. All of its financing projects have to demonstrate environmental sustainability, as per the Bank's Articles of Agreement. The Environmental and Social Policy is reviewed every three years to help ensure the Bank adopts state-of-the-art best practices in all projects.

In promoting economic transition, the Bank acts as a catalyst for increased flows of financing to the private sector, as the capital requirements of these countries cannot be fully met by official multilateral or bilateral sources of financing, and many foreign private investors remain hesitant to invest in the region, particularly the Central Asian republics.

The EBRD's operations to advance the transition to a market economy are guided by four principles: transition impact, additionality, sound banking and environmental sustainability. Financing is provided for projects that expand and improve markets, help to build the institutions that underpin a market economy, and demonstrate and promote market-oriented skills and sound business practices. EBRD financing must also mobilize additional sources of financing and not displace them. Bank projects must be sound from a banking perspective, thus demonstrating to private investors that the region offers attractive returns. Adherence to sound banking principles also ensures the financial viability of the EBRD and hence its attractiveness as a co-investment partner for the private sector. Integrity is another important aspect of the Bank's due diligence in selecting projects.

⁴ Article 1 of the Agreement Establishing the European Bank for Reconstruction and Development.



The Bank's medium-term operational priorities are premised on: the central importance of creating and strengthening those institutions that ensure markets work well; the key role that small businesses can play in creating dynamic, competitive and more equitable economies; and the key role the transition process plays in supporting the principles of multiparty democracy and pluralism.

To achieve these priorities the Bank focuses on:

- Developing market-based and commercially oriented infrastructure.
- Developing sound financial sectors linked to the needs of enterprises and households.
- Providing leadership for the development of lending to micro, small and medium-sized enterprises.
- Demonstrating, through selected examples, effective approaches to restructuring viable large enterprises.
- Diversifying the economic base and developing knowledge-based industries.
- Taking an active approach in its equity investments to improve corporate governance.
- Engaging governments in policy dialogue to strengthen institutions and improve the investment climate.
- Tackling energy efficiency, climate change and energy security.
- Promoting transparency and accountability in public sector management.
- Taking a regional approach where appropriate.
- Promoting sustainable development and environmental due diligence.

The EBRD differs from other regional development banks in several ways:

- The Bank's overriding focus is on the private sector. Its charter stipulates that at least 60 per cent of its financing commitments, on both a portfolio-wide and country basis, should be directed either to private sector enterprises or to state-owned enterprises that are being privatized.
- The Bank's mandate gives it an explicit focus on the promotion of democratic institutions in its countries of operations. The EBRD is the only international financial institution with this charter requirement.
- The EBRD does not provide concessional financing and poverty reduction is not specifically part of its mandate, although development of the private sector in its countries of operations should lead to increased employment and thus help reduce poverty. The Bank's work in financing micro, small and medium-sized enterprises is important in this regard, as is the work on gender equality.



How the EBRD Works

Project Finance

The EBRD offers a full array of financial products and services, including:

- Longer-term loans.
- Equity investments.
- Quasi-equity instruments (subordinated loans, preferred stock, income notes).
- Guarantees and standby financing.
- Working capital and trade finance facilities.
- Risk management (intermediation of currency and interest rate swaps, provision of hedging facilities).

Eligibility

Eligible projects must be supported by a strong business case, benefit the economy and the transition process of the host country, and comply with the EBRD's environmental guidelines. Projects in all industries are eligible for EBRD financing, except those producing military equipment, tobacco and distilled alcohol. Although it is primarily a financier of private sector projects, the Bank may provide financing to state-owned companies, provided they are operating competitively and, in particular, that such financing facilitates or enhances the participation of private and/or foreign capital in such enterprises. The EBRD can finance private companies that are wholly locally owned or foreign owned, as well as joint ventures between foreign and local shareholders.

In order to ensure the participation of investors and lenders from the private sector, the EBRD generally limits the total amount of debt and equity financing for any single project to 30 per cent of total estimated project costs. However, in certain circumstances, and particularly in the current environment, where the syndications market is closed to most of the Bank's clients, the Bank provides a larger share of the project costs. In rare cases, such as when a project is in corporate recovery, the Bank may become the largest shareholder in order to turn the company around and sell it.

Smaller projects are financed both directly by the EBRD and through local financial intermediaries. By supporting local commercial banks, micro-finance organizations, equity funds and leasing facilities, the EBRD has helped finance over 1 million smaller projects.



Fees

The EBRD charges market rates for its private sector financing and provides uniform loan pricing for sovereigns of LIBOR (London Interbank Offered Rate) +100 basis points. In addition, fees vary according to the nature of the project and the amount and complexity of the work required of the EBRD.

Funding of EBRD Activities

The EBRD's equity and quasi-equity investments are funded out of its net worth—the total of paid-in capital and retained earnings. Of the funding required for its lending operations, 100 per cent is borrowed in the international financial markets through public bond issues or private placements.

The EBRD's bond issues have been given AAA ratings by both Moody's Investors Service and Standard & Poor's.

Policy Dialogue

The Bank uses its close relationship with governments in the region to promote policies that bolster the business environment. The EBRD advises governments on promoting a sound investment climate and stronger institutional framework, which are important for the functioning of the private sector. This dialogue is typically supportive of projects in which the Bank invests. Specifically, the EBRD works with government officials to promote sound corporate governance, anti-corruption practices, fair and predictable taxation policies and transparent accounting standards. In addition, a dedicated legal team advocates for an effective legal and regulatory framework which is not directly tied to a project.

Technical Cooperation

Technical cooperation improves the preparation and implementation of the EBRD's investment projects and provides advisory services to private and public sector clients. It increases the impact of EBRD projects on the transition process by supporting structural and institutional changes, and it assists legal and regulatory reform, institution building, company management and training. Technical cooperation is important to the Bank as it allows thorough preparations for investments, more effective investments in general and investment opportunities in higher-risk environments in particular.

Technical cooperation projects are funded by governments and international institutions and are managed by the EBRD.



EBRD Governance and Oversight

The highest authority in the Bank is the Board of Governors. It meets annually and approves the institution's annual report, net income allocation and financial statements, the independent auditor's report, the election of the Chair and Vice-Chair for the next Annual Meeting, as well as other items requiring Governors' approval. A Governor and an Alternate Governor represent each of the 66 shareholders.

The Board of Directors is responsible for the general operations of the Bank. It is composed of 23 members, with each representing either one member country or a constituency of member countries. The Board helps to set the strategic and financial course for the Bank, in consultation with management.

Board Committees

The Board has established four committees that are responsible for overseeing the activities of the Bank: the Board Steering Group, the Audit Committee, the Budget and Administrative Affairs Committee, and the Financial and Operations Policies Committee. This division of labour is consistent with good corporate governance practices and provides an appropriate system of checks, balances and incentives. In addition, the structure ensures a more effective discussion by the Board, once initiatives are ready for approval.

The Board Steering Group is responsible for the coordination of the Committees' work programs to avoid overlap and ensure timely completion. In addition to some administrative duties, the Chair of the Group is the main liaison between the Board and management. The Group is currently chaired by the German Director.

The Audit Committee's primary objective is to ensure that the financial information reported by the Bank is complete, accurate, relevant and timely. The Committee oversees the integrity of the Bank's financial statements and the compliance of its accounting and reporting policies with the requirements set out in the International Financial Reporting System. It also reviews the EBRD's system of internal controls and its implementation, as well as the functions of the internal audit, evaluation and risk management teams. The Committee is currently chaired by the Dutch Director.

The Budget and Administrative Affairs Committee is responsible for ensuring that the Bank's budgetary, staff and administrative resources are aligned with its strategic priorities. To this end, the Committee reviews the medium-term resource framework, annual budgets and the business plan. It also oversees the Bank's human resources policies, including ethics and the Code of Conduct. The Committee is currently chaired by the Turkish Director. The Canadian Director is currently a member of the Committee.



The Financial and Operations Policies Committee oversees the Bank's financial and operational policies, including the annual borrowing plan prepared by the Treasury Department. The Committee is responsible for the transparency and accountability of the Bank's operations, as laid out in the 2006 Public Information Policy. Since 2007, the Committee has also been charged with overseeing the net income allocation process. As well, it is responsible for the renewal of the Bank's Environmental and Social Policy. The Committee is currently chaired by the UK Director.

For More Information on the EBRD

The Bank releases considerable information on its various activities. Bank publications include information guides (such as *Guide to EBRD Financing*), evaluation reports, special reports (such as the *Annual Report* and *Transition Report*), country strategies and assorted fact sheets.

Information can also be obtained on the Bank's website (www.ebrd.com).

Requests for information can be addressed to:

Publications Desk
European Bank for Reconstruction and Development
One Exchange Square
London, EC2A 2JN
United Kingdom

Or to: Office of the Director for Canada, Morocco, Jordan and Tunisia
canadaoffice@ebrd.com



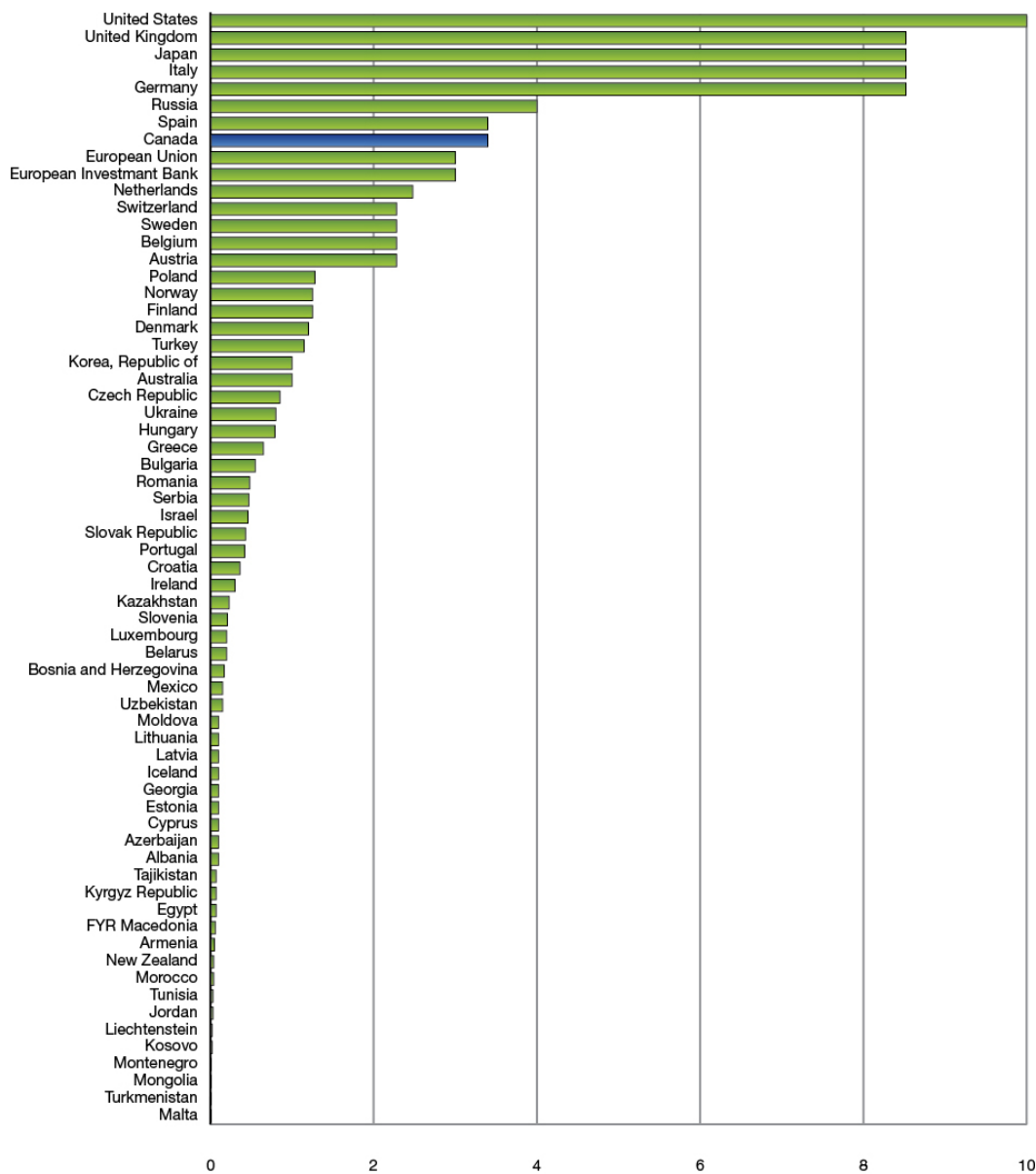
Annex 1

EBRD Membership

The EBRD's share capital is provided by member countries, with proportional voting rights. Chart 1 provides shareholdings as at December 31, 2012.

Chart 1

Shareholding as a Percentage of Authorized Capital Stock

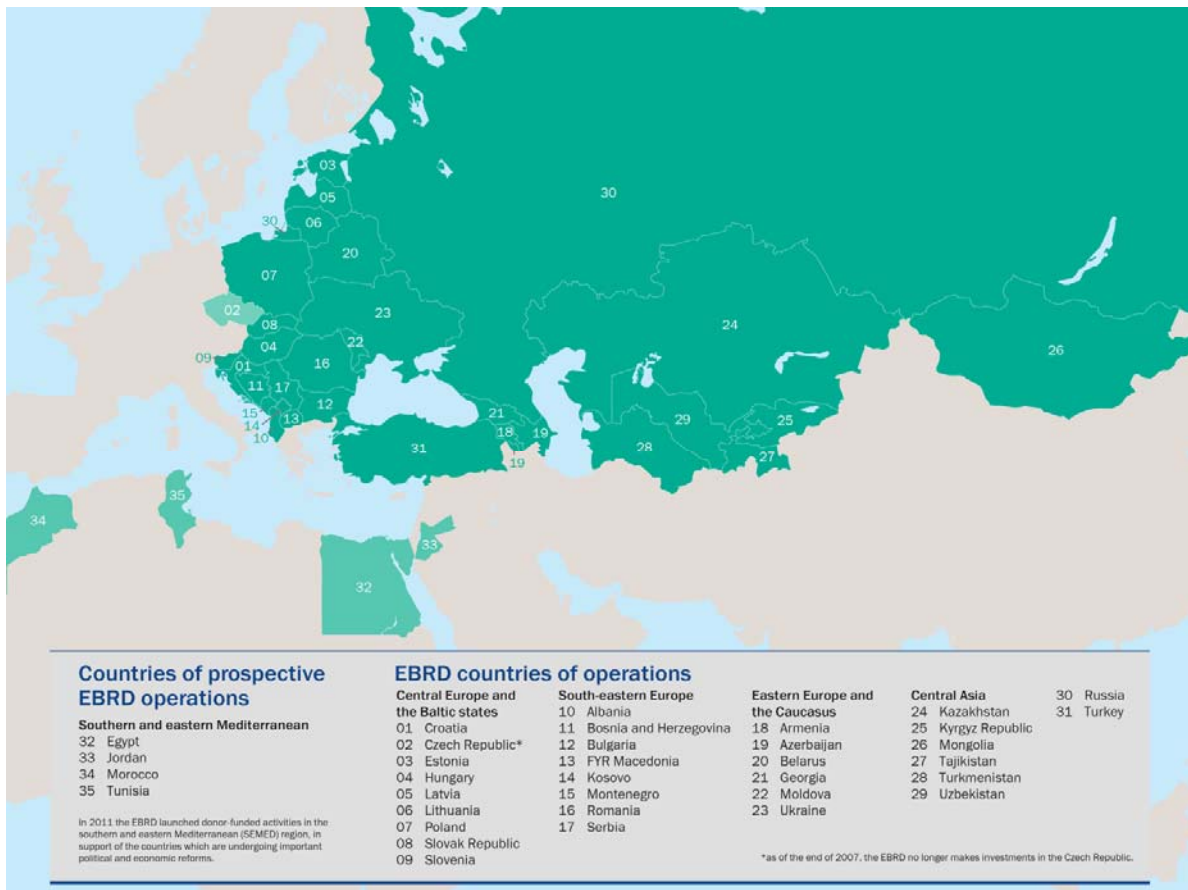




Annex 2

Countries of Operations

The EBRD has 66 shareholders: 64 countries, the European Union and the European Investment Bank. There were 30 countries of operations and 4 prospective countries of operations in 2012.



Source: EBRD.



Annex 3

2012 Governor's Speech

**Statement by the Honourable Ted Menzies,
Minister of State (Finance),
and Temporary Alternate Governor for Canada,
at the EBRD Annual Meeting
London, UK, May 19, 2012**

I would like to thank the UK Government, the City of London and the European Bank for Reconstruction and Development for graciously hosting the 21st Annual Meeting of the EBRD.

Canada is a proud partner of this institution and believes strongly in the Bank's core mission to foster the transition towards market-oriented economies and to invest in countries that have demonstrated a commitment to economic and democratic reforms.

For the region and for the EBRD, 2011 proved to be an eventful year. During periods of instability and upheaval such as that which unfolded in parts of the Arab world, nations turn to international financial institutions like the EBRD for support. This is why, for example, a key component of the G-8 Deauville Partnership, launched in May 2011, is the expansion of the EBRD's geographic mandate to include the Southern and Eastern Mediterranean region.

Canada has been fully supportive of this initiative throughout, and we are pleased to be able to confirm our ratification of the amendments to the Agreement Establishing the EBRD. In addition, Canada is very pleased to have recently welcomed the two newest members of the EBRD—the Hashemite Kingdom of Jordan and the Tunisian Republic—into our constituency at the EBRD Board of Directors. It is our hope that this will allow our countries to continue to grow and build upon existing relationships. Canada also looks forward to working closely with the EBRD and our fellow members to ensure a successful and timely expansion of Bank operations in the new region.

It is important to recognize the EBRD's work in all of its countries of operations during 2011. Canada is therefore pleased to see that the Bank's financing activities continue to have a high transition impact while meeting sound banking principles, even in the face of a challenging economic climate.

The EBRD also continues to foster economic growth that is sustainable in the long run. We are pleased that Phase 2 of the EBRD's Sustainable Energy Initiative met or surpassed all of its targets, representing a valuable source of leverage for private sector investment in an important sector of the economy. In addition, Canada has been encouraged by the EBRD's growing leadership role in developing local currency capital markets in the region, through the Local Currency and Local Capital Markets Initiative.



Looking Ahead

The events of the past year have raised the international profile of the EBRD, and it is clear that the year ahead will bring both challenges and opportunities. Given the EBRD's finite resources and the growing demand for its expertise, it is more important than ever that the EBRD focus its activities on the countries with the largest transition gaps. That should include positioning the Bank's operations to facilitate the graduation of the EU-7 countries by 2015, in accordance with the commitment made as part of the fourth Capital Resources Review.

It is critical that the EBRD adhere to the core principles of its mandate in order to maintain legitimacy in the eyes of its shareholders and clients. Thus it will be important for the EBRD to focus its resources on the countries that continue to demonstrate a commitment to the principles of pluralism and multiparty democracy. In countries where that commitment is waning, the EBRD should take steps to limit its engagement accordingly—as it has done in a limited number of cases already. Equally important for EBRD legitimacy is the staffing of its leadership positions through open and transparent processes based upon merit. While overall the EBRD has made excellent progress on this front, more needs to be done. Canada therefore calls upon the EBRD Board of Directors to develop recommendations to Governors to establish formal procedures for future EBRD Presidential elections.

In closing, I would like to thank outgoing EBRD President Mirow, all EBRD staff and management, and the Board of Directors for a remarkable term full of achievement. I would also like to congratulate and welcome incoming EBRD President Suma Chakrabarti and I look forward to continuing our collaboration under his leadership.

As economic uncertainty continues to cast a shadow over the region's economic recovery, it will be important that the EBRD continue to play a central role in its countries of operations. We are confident that the EBRD staff and management are up to the task, and the Bank can continue to count on Canada's support for its mission in the years to come.

I look forward to meeting you all again in Istanbul in 2013.



Annex 4

CIDA Programming and Other Canadian Bilateral Assistance in EBRD Countries of Operations

In order to increase the effectiveness of its programming, the Canadian International Development Agency (CIDA) is focusing its efforts on a limited number of countries. In the EBRD region, efforts are therefore concentrated in Ukraine, which is one of CIDA's 20 countries of focus.

Other EBRD countries of operations benefit from CIDA support through multilateral funds, such as the Global Fund to Fight AIDS, Tuberculosis and Malaria, and through contributions to Canadian and international civil society partners, which are mostly engaged in support of governance and human rights. For instance, CIDA currently supports the training of citizens and capacity development of institutions in EBRD countries on issues such as human rights (Equitas, Disabled Peoples' International) and anti-corruption (the U4 Anti-Corruption Resource Centre, Transparency International). In 2012–13, CIDA provided \$8.9 million to CANADEM and the Organization for Security and Co-operation in Europe (OSCE) and its Parliamentary Assembly for the deployment of 500 Canadians to observe the October 28, 2012 parliamentary elections in Ukraine. CIDA also provided \$23,119 to the OSCE to send four observers to the March 4, 2012 elections in Russia.

The highlights of CIDA's programming in EBRD countries of operations can be found below.

Ukraine—Since 1991, Canada has contributed more than \$410 million in bilateral official development assistance. CIDA's objective in Ukraine is to improve economic opportunities for Ukrainians in a strengthened democracy. Sustainable economic growth is being pursued by improving the business-enabling environment and increasing the competitiveness of small and medium-sized enterprises, including farms, in domestic and international markets. To strengthen democracy in Ukraine, CIDA focuses on increasing equitable access to justice for all Ukrainians and improving the participation of Ukrainian citizens in public life and decision-making.

Europe Regional Program—The Europe Regional Program, which ended in December 2012, was established in 2007 to further refine CIDA's interventions, address ongoing transboundary issues in the region and meet the specific needs of the South Caucasus. Canada's twin objectives of democratic and economic reform guided CIDA's programming direction. CIDA supported initiatives aimed at facilitating the transition to a free market economy through the EBRD.



Canada also has limited bilateral programming through the Canada Fund for Local Initiatives (CFLI). CFLI funding is available for the following EBRD countries of operations: Bosnia and Herzegovina, Serbia, Montenegro, Albania, Tajikistan, Kazakhstan, the Kyrgyz Republic, Azerbaijan, Georgia and Turkey. The responsibility for managing the CFLI was moved from CIDA to Foreign Affairs and International Trade Canada in 2012. The program assists in financing small local projects in countries appearing on the Organisation for Economic Co-operation and Development's Development Assistance Committee list, including several in the EBRD region. All projects funded through the CFLI (typically between \$20,000 and \$50,000) must be consistent with Canada's five thematic priorities for development assistance: stimulating sustainable economic growth, increasing food security, creating opportunities for children and youth, advancing democracy and ensuring security and stability. In the future, it is expected that a higher percentage of programming will align with the priorities of advancing democracy and ensuring security and stability. Features of the program that shaped its success in the past have not changed, in particular its decentralized decision-making and responsiveness to local needs.



Annex 5

Summary of *Transition Report 2012:* *Integration Across Borders*

The *Transition Report* is an annual report published by the EBRD on the state of economic, political and social developments taking place in the EBRD's region of operations. The following is a brief overview of the 2012 *Transition Report*. The full report is available on the EBRD's website (www.ebrd.com/pages/research/publications/flagships/transition.shtml).

Economic Trends

The economic situation in the EBRD's region of operations worsened significantly in 2012, largely as a result of the weakening euro area economy and the sovereign debt crisis. Financial institutions in the euro area have undergone a general retrenchment, partly in response to new financial regulations, withdrawing capital from subsidiaries and significantly reducing cross-border lending. Banks in the EBRD's region of operations have lost crucial external funding, with the resulting credit crunch leading to slower economic output.

Central and Southeastern Europe are closely integrated with the euro area, while Eastern Europe and Central Asia are more closely linked to Russia's economy. Ukraine appears to be exposed to developments in both the euro area and Russia, while Poland's economy has generally demonstrated a high level of resilience to changes in the external environment. The EBRD forecasts that the region's economy will see a slowdown relative to 2011 in both 2012 and 2013, with plenty of downside risks. The EBRD expects that the economies most closely integrated with the euro area will decelerate the most, with recessions in Croatia, Hungary and Slovakia deepening further.

Global trends such as rising commodity prices are also playing a role in dampening the region's economic growth. Depressed global commodity demand and investor capital flight will impact Russia, which is also expected to see slower growth in 2013.

Progress on Transition in Countries of Operations

2012 was a difficult year for the transition region. Generally, the EBRD's countries of operations remain committed to markets and competition, but there has been no great push for reforms that would allow countries to reach their long-run potential. This is not surprising given the economic climate and—as highlighted in the 2011 *Transition Report*—greater public skepticism of market reforms following from the financial crisis.



Unlike in recent years, there were several examples of backsliding on reforms, mainly in the form of national governments increasing their involvement in markets. This was the case in the energy sector in Bulgaria, Romania (both EU members) and Kazakhstan, and in the natural resources sector in Hungary.

By contrast, important progress was made in certain sectors such as the financial sector, particularly local currency markets. Certain transport sectors have also seen important progress. See the full 2012 *Transition Report* for a country-by-country analysis of the EBRD's countries of operations.

The Southern and Eastern Mediterranean Region

For the first time, the *Transition Report* includes a discussion of the SEMED countries, evaluating them using the same criteria that are used for the existing countries of operations. Although the SEMED countries share a similar history with the post-communist countries, they differ in important respects, including a more gradual pace of reform and very high levels of youth unemployment. Overall, the EBRD deems the countries of the SEMED region to be “mid-transition,” on par with the Caucasus countries, Kazakhstan and Ukraine. Trade and capital flows are predominantly liberalized, while most of the economy is privately owned. However, market structure and institutional reforms need to be accelerated, with the power and energy sectors being the least reformed sectors. In addition, subsidies for food and fuel distort markets and represent a large fiscal burden for the SEMED country governments.

Economic Integration in the EBRD Region

The theme of this year's *Transition Report* is economic integration in the region and its implications. The report starts by examining the impact of the financial crisis on cross-border finance. In particular, the international spillovers from the 2007–2008 crisis resulted in calls for greater cross-border financial regulation and supervision. In the European Union the solution involved new supervisory institutions that became operational in 2011, including the European Banking Authority and the European Systemic Risk Board. In addition, in late June 2012 euro area governments committed to creating “a single supervisory mechanism involving the European Central Bank” that would make it possible for troubled euro area banks to be recapitalized directly using European Stability Mechanism (ESM) funds.

The report looks at the implications of these developments for the EBRD's countries of operations and concludes that the reforms offer a significant degree of progress, but remain incomplete. Unified bank supervision and harmonized resolution frameworks will allow the ESM to serve as a safety net for the entire euro area—going a long way to addressing coordination failures within the single currency area. However, bank resolutions will still be handled at the national level, resulting in the same coordination challenges as before. There is also potential for moral hazard at the national level if the resources for a financial bailout are coming from the European-wide source.

In addition, non-euro area members could not access the ESM for bank recapitalization even if they accept the supervisory mechanism, creating an unlevel playing field. The EBRD's proposals to address these shortcomings include allowing ESM coverage for countries that opt in to the supervisory mechanism, and requiring that countries that receive ESM support be required to share banking-related fiscal losses up to a pre-determined point.



A second example of economic integration is the Common Economic Space of the Eurasian Economic Community. Established as a Customs Union in 2009 between Belarus, Kazakhstan and Russia, this is the first successful attempt at an economic union involving countries of the former Soviet Union. As of January 2010, the Customs Union applied a common import tariff to all goods entering the region.

The scope for institutional convergence is more limited in the Customs Union than in other regional integration entities because there is little variation in institutional quality among the members and no country has strong enough institutions to serve as a natural model to follow. The challenge is therefore to leverage deeper integration with supranational governance structures in order to create supranational-level institutions that are stronger than those of the individual members.

Key benefits of the Customs Union include greater competition between jurisdictions, due to the greater ease with which firms can choose environments with a better business climate. This could, in turn, incentivize members to improve their macroeconomic policies. The Customs Union has provided some trade creation effects, mainly for Russia, but the magnitude of these effects is small. There is some evidence that the Customs Union can also serve as a “springboard for exports” by allowing higher-value-added goods to be exported within the Union prior to export. However, the lowering of non-tariff barriers will be necessary to take greater advantage of this effect.