Organisation, governance and activities

This chapter provides an overview of the internal organisation and governance of the Bank for International Settlements (BIS). It also reviews the activities of the Bank, and of the international groups it hosts, over the past year. These activities focus on the promotion of cooperation among central banks and other financial authorities, and on the provision of financial services to central bank customers.

Organisation and governance of the Bank

The Bank, its management and shareholders

The BIS is an international organisation that fosters international monetary and financial cooperation and serves as a bank for central banks. Its head office is in Basel, Switzerland, and it has two representative offices, one in the Hong Kong Special Administrative Region of the People's Republic of China and one in Mexico City. The Bank currently employs 554 staff from 49 countries.

The BIS fulfils its mandate by acting as:

- a forum to promote discussion and facilitate decision-making among central banks and to support dialogue with other authorities with responsibility for financial stability;
- a centre for economic and monetary research;
- a prime counterparty for central banks in their financial transactions; and
- an agent or trustee in connection with international financial operations.

The Bank also hosts the secretariats of a number of committees and organisations that seek to promote financial stability:

- The Basel Committee on Banking Supervision, the Committee on the Global Financial System, the Committee on Payment and Settlement Systems and the Markets Committee have been established by the Governors of the G10 central banks over the past 40 years. They enjoy a significant degree of autonomy in setting their agendas and structuring their activities.
- The Financial Stability Forum, the International Association of Insurance Supervisors and the International Association of Deposit Insurers are independent organisations that do not directly report to the BIS or its member central banks.

Details of the role and recent activities of these committees and organisations are provided below.

The Bank has three main departments: the Monetary and Economic Department, the Banking Department and the General Secretariat. These are supplemented by the Legal Service, the Compliance, Internal Audit and Risk

Control units, and the Financial Stability Institute, which fosters the dissemination of standards and best practices to financial system supervisors worldwide.

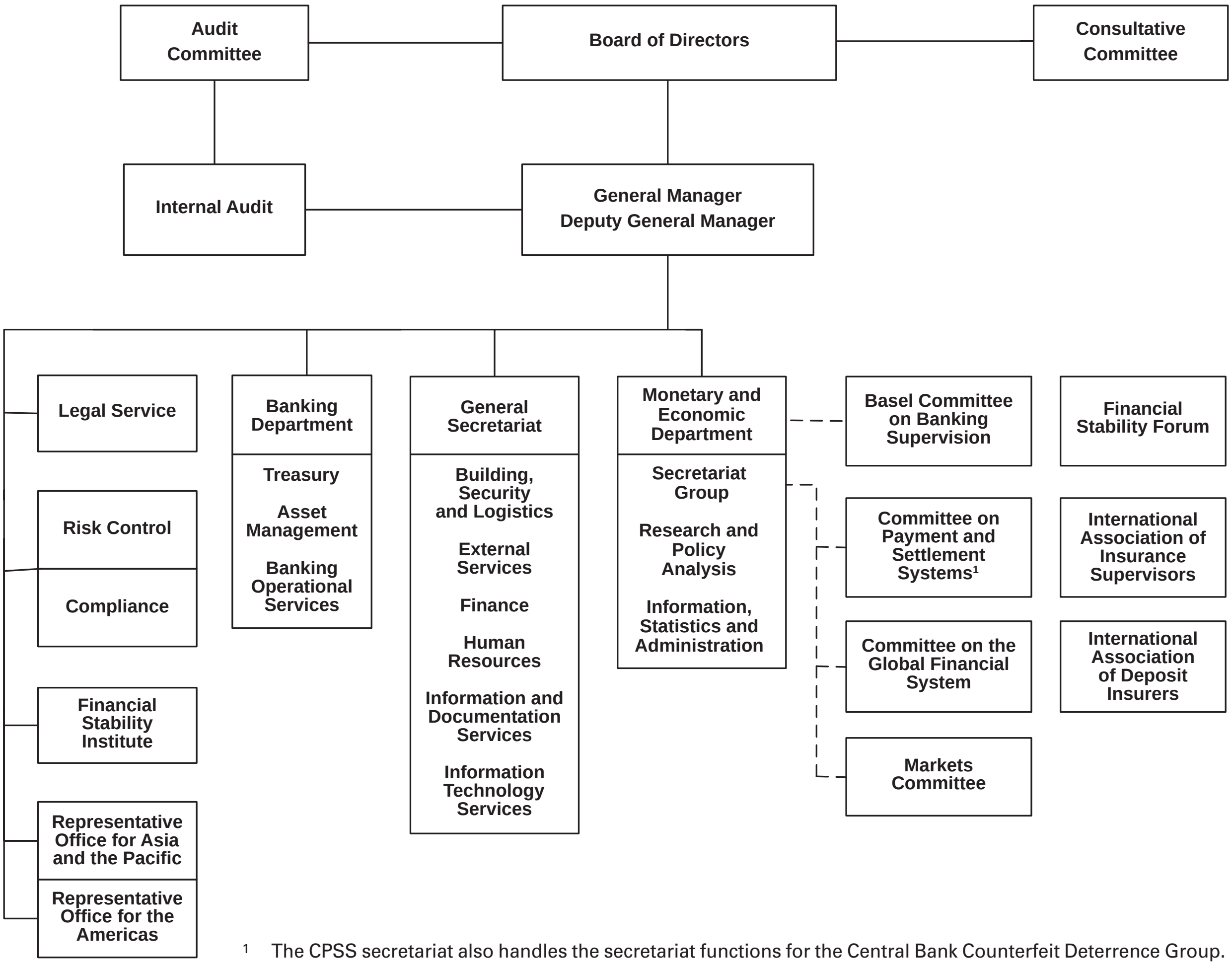
There are three main bodies for governing and administering the Bank:

- the General Meeting of member central banks. Fifty-five central banks or monetary authorities currently have rights of voting and representation at General Meetings. The Annual General Meeting is held within four months of the end of the Bank's financial year, 31 March. In 2005, 110 central banks took part, including 84 at Governor level. Delegates from 21 international institutions also attended;
- the Board of Directors, currently comprising 17 members. Its main tasks include determining the strategic and policy direction of the Bank and supervising the Bank's Management. The Board is assisted by the Audit Committee and the Consultative Committee, composed of selected Directors; and
- the Executive Committee, chaired by the General Manager and comprising the Deputy General Manager, the Heads of Department and other officers of similar rank appointed by the Board. The Executive Committee advises the General Manager on all important matters affecting the Bank as a whole.

An Extraordinary General Meeting held in conjunction with the Bank's 2005 Annual General Meeting decided to revise the BIS Statutes to streamline the governance of the Bank. This followed a review undertaken by the Bank the previous year to enhance the transparency of its operations and structure. As a result, the position of President of the BIS was abolished, effective 27 June 2005. The positions of Chairman of the Board and President had been vested in one person since 1948. The review also recognised terms of reference for the Executive Committee as an advisory committee to the General Manager, and Charters for the Board of Directors and several operational committees were drawn up.

Member central banks, Directors and senior officials, and recent changes in the composition of the Board and Management are listed at the end of this chapter.

Organisation of the BIS as of 31 March 2006



1 The CPSS secretariat also handles the secretariat functions for the Central Bank Counterfeit Deterrence Group.

Promotion of international financial and monetary cooperation: direct contributions of the BIS during 2005/06

In early 2006, the BIS announced initiatives to deepen relationships with its strategic partners in Asia following an intensive consultation process with BIS member central banks in the region. The initiatives comprise a three-year research programme on monetary and financial issues in Asia and the Pacific, an expansion of the work of the Financial Stability Institute in the region, and an extension of banking services from the BIS Representative Office in Hong Kong SAR.

Regular consultations on monetary and financial matters

Every two months, the Governors and other senior officials of the BIS member central banks convene for a series of meetings to discuss current economic and financial developments and the outlook for the world economy and financial markets. They also exchange views and experiences on issues of special and topical interest to central banks. These bimonthly meetings are one of the most important ways in which the Bank promotes cooperation within the central banking community. In addition, the Bank organises various other meetings, on a regular or an ad hoc basis, for senior central bank officials. In a number of these meetings, other financial authorities, the private financial sector and the academic community are invited to contribute to the dialogue.

The Global Economy Meeting, which brings together the Governors of key industrial and emerging market economies, monitors economic and financial developments and assesses the risks and opportunities in the world economy and financial markets. The meetings of Governors of the G10 countries and those of Governors of key emerging market economies often explore conjunctural themes that are of special relevance to the respective groups of economies. The G10 Governors also discuss issues pertaining to the work of the permanent central bank committees hosted by the Bank.

Because not all central banks are directly involved in the work of the committees and other organisations hosted by the Bank, a periodic Review Meeting for Governors briefs them on the activities of these specialised groupings. On occasion, the Review Meeting also explores a topic of direct importance to this group of central banks. In 2005/06 Governors discussed:

- recent developments in the oil market;
- foreign exchange market issues;
- Basel II and issues of home and host country supervision;
- the revised Core Principles for Effective Banking Supervision;
- housing finance; and
- the relationship between the central bank and the government.

Finally, issues of a more structural nature and of general interest to all BIS member central banks were discussed in the All Governors Meetings:

- central banks and financial stability: objectives, instruments and accountability;
- the effects of globalisation on wage and price formation. What has changed and does it matter?;
- credit markets, complex financial products and risk management;
- issues and prospects of ERM II and accession to the euro area; and
- the measurement of inflation for monetary policy.

In analysing issues related to financial stability, Governors attach importance to dialogue with heads of supervisory agencies, other financial authorities and senior executives from the private financial sector. The Bank regularly organises informal discussions among public and private sector representatives that focus on their shared interests in promoting and maintaining a sound and well functioning financial system.

Other meetings organised for senior central bankers on a less frequent basis include:

- the biannual central bank economists meeting, which in October 2005 examined the evolution of the inflation process;
- the meetings of the working parties on domestic monetary policy, which are not only held in Basel but are also hosted by a number of central banks in Asia, central and eastern Europe, and Latin America; and

- the meeting of Deputy Governors of emerging market economies, for which this year's theme was progress in the banking system in emerging economies.

Other areas of central bank cooperation promoted by the BIS

Research activities

In addition to providing background material for meetings of senior central bankers and secretariat services to committees, the BIS contributes to international monetary and financial cooperation by carrying out its own research and analysis on issues of interest to central banks and, increasingly, financial supervisory authorities. This work finds its way into the Bank's regular publications, such as the *Annual Report*, the *Quarterly Review* and the *BIS Papers* and *Working Papers* series, as well as external professional publications. Most of the Bank's research is published on its website (www.bis.org).

In line with the Bank's mission, the long-term focus of the research is on monetary and financial stability issues. Themes receiving special attention during the period under review included:

- changes in the inflation process, in particular the linkages between inflation and globalisation as well as the role of the exchange rate;
- the measurement and pricing of credit risk, notably as reflected in new financial instruments such as credit derivatives;
- the measurement of risk appetite and its impact on the pricing of financial assets;
- trends in international banking;
- coordination between monetary and prudential policies; and
- the nexus between risk management, accounting and prudential regulation.

As part of its research activities, the BIS also organises conferences and workshops, typically bringing together senior policymakers, academics and market participants. In June 2005, in the broader context of the Bank's celebrations marking its 75th anniversary, the Fourth BIS Annual Conference addressed the past and future of central bank cooperation. In November a high-level workshop was devoted to an analysis of the relationship between accounting, risk management and prudential regulation.

Cooperation in the statistical area

A major development in the statistical area was the decision by the BIS in January 2006 to provide the Secretariat of the Irving Fisher Committee on Central Bank Statistics (IFC). This is a global forum of users and compilers of statistics at central banks, which has operated informally since 1997 under the auspices of the International Statistical Institute (ISI). The Committee is currently chaired by Jan Smets, Director at the National Bank of Belgium and alternate BIS Board member. In April 2005 the Committee organised a number of meetings at the 55th ISI Session in Sydney. It also co-sponsored a workshop with the Bank of Canada in June 2005 on "Data requirements for analysing the stability and vulnerability of mature financial systems". In April 2006 it organised a workshop on "CPI measurement: central bank views and concerns", which was attended by most of the central banks represented at the BIS Global Economy Meeting. Preparations are under way for the Third IFC Conference, to be held at the BIS at the end of August 2006 on the topic of "Measuring the financial position of the household sector". Information on the IFC, including on the governance of the Committee and the papers from its various meetings, is available at www.ifcommittee.org.

BIS support for the IFC reflects the fact that statistical data and related methodological issues are becoming increasingly important to central banks, from the perspective of both monetary and financial stability. Hosting the IFC Secretariat is also a natural extension of other services that the BIS provides to the central bank statistical community, including the BIS Data Bank and the collection of various international financial statistics.

Four central banks officially became new participants in the BIS Data Bank last year: those of Argentina, Brazil, China and India. This brings the total number of contributors to 39, almost all of which are BIS shareholding central banks. Moreover, those BIS shareholding central banks that do not participate in the Data Bank were invited to begin reporting a limited number of key economic indicators to the BIS as a contribution to the background statistical material prepared for the BIS bimonthly meetings.

In October 2005, 35 central banks participated in the biennial Meeting of Experts on (BIS) International Financial Statistics, which reviewed a number of analytical and technical issues related to these statistics. Last year, the reporting framework was extended for the consolidated banking statistics (to provide more information on ultimate risk exposures, including off-balance sheet data) as well as for the OTC derivatives statistics (to include data on credit default swaps). Data from Korea were included in the BIS locational banking statistics, and information from Croatia and Pakistan was added to the domestic securities statistics. At the end of 2005, the BIS also decided to release preliminary data for its international banking statistics a number of weeks before their official publication in the *BIS Quarterly Review*. In addition, preparations started for the next Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity, to be carried out in 2007, in which the central banks of more than 50 countries are expected to participate.

The BIS worked very closely last year with the IMF, OECD and World Bank, in the context of the Inter-Agency Task Force on Finance Statistics, to establish a new Joint External Debt Hub. This web-based facility (www.jedh.org), launched in March 2006, brings together improved data from creditor and market sources on external debt components with external debt data available from national statistical agencies.

The Joint External Debt Hub makes full use of the technical standards, content-oriented guidelines and implementation tools developed by the Statistical Data and Metadata Exchange (SDMX) initiative. On behalf of the central banks participating in its statistical activities, the BIS contributes to SDMX together with the ECB, Eurostat, the IMF, the OECD, the United Nations and the World Bank. By end-March 2006, all major building blocks of SDMX had been released at www.sdmx.org. These include a number of technical specifications, which have been approved by the International Organization for Standardization (ISO). Preliminary discussions with XBRL International, provider of a similar standards framework for accounting information, have confirmed the potential for making the frameworks for exchanging statistical and accounting data interoperable, and further work in this direction is expected. The BIS will chair the SDMX Sponsors Committee in 2006–07.

Central bank governance

The Bank has been conducting activities in the area of central bank governance for more than a decade. Throughout this period, it has been guided by the objective of meeting the growing needs of central banks for timely and accurate information and well focused analysis. In May 2005, these activities were formalised with the approval by the Governors of BIS shareholder central banks of a charter establishing the Central Bank Governance Forum. The purpose of the Forum is to foster the good governance of central banks as public policy institutions. The Governance Forum consists of the Central Bank Governance Group and the Central Bank Governance Network. Secretariat support is provided by the BIS.

The Governance Group comprises Governors from a broadly based and representative group of central banks. Its members discuss topical issues of central bank governance. They also invite Governors from other central banks to participate in their discussions whenever the topic at hand is of particular relevance to those central banks. During the past year, the Group considered a range of issues, including freedom of information legislation and central banks, the role of the Governor as chairperson of major boards and committees of the central bank, and the relationship between the central bank and government. In keeping with the advice of the Governance Group, the BIS accords priority to addressing governance questions that are critical for the effective operation of independent and accountable monetary authorities.

The Governance Network spans more than 45 major central banks and monetary authorities around the world. Members contribute actively to efforts by sharing information on central banks' approaches to institutional and organisational matters. This collegial approach enables the collection of information on mandates, powers, operations and accountability arrangements that can be used by central banks to strengthen their institutions.

Group of Computer Experts of the G10 central banks

In last year's two meetings of the Group of Computer Experts and the two convened for its Working Party on Security Issues, discussions focused primarily on IT governance, business continuity planning, protection of internal systems from external threats, and mobile computing or remote access. Group members benefited from sharing with their peer organisations the experience gained with various models for internal IT governance, achieving an appropriate balance between innovation and standardisation, and the underlying reasons for the failure of many IT governance models.

Business continuity planning received additional priority, given the need for increased preparations for a possible avian flu pandemic, which would primarily affect human resource availability (including dependencies on external services) rather than IT systems.

Security threats, while still significant, resulted in marginally fewer disruptions than in previous years, probably due to the increase in available industry tools and measures for detecting and eradicating these threats, particularly viruses. Solutions against spam e-mail are now also more widely deployed, reducing the effects of this nuisance threat. Mobile computing and its associated risks continue to be an area requiring constant attention, driven by both business expectations and market developments.

Other topics covered at the Group's meetings included service sourcing models, the benefits of internal IT audits, and compliance with nominal industry IT standards (such as ITIL).

Internal Audit

Since 1986, G10 central bank auditors have met regularly to share experience and knowledge in their area of expertise, and to address new issues and challenges. The main topics for discussion usually derive from international internal auditing standards and the continuous need to improve controls over the risks faced by central banks. Twice a year, the BIS's Internal Audit unit organises and hosts the meetings of the G10 Working Party on IT Audit Methodologies.

In June 2005, the BIS participated in the 19th Annual Plenary Conference of G10 Heads of Internal Audit, hosted by the Bank of Japan and covering in particular: the role of internal audit in the ethics and ethical awareness of an organisation; the implications of the Sarbanes-Oxley Act; auditing corporate governance; the role of internal audit in IT governance; and auditing business continuity management (for the last topic, the BIS coordinated the work of a G10 task force).

Following several meetings of internal audit heads from Asia-Pacific central banks and monetary authorities, BIS Internal Audit has established a contact and information sharing network with these institutions.

Cooperation with regional central bank groupings

The Group of Coordinators of Technical Cooperation and Training, set up in the early 1990s to coordinate central bank technical assistance to former planned economies, held its annual meeting in St Petersburg in June 2005, with the Central Bank of the Russian Federation as host. The meeting confirmed that the nature of technical cooperation amongst central banks is changing in a number of ways. Instead of traditional forms of technical assistance, training activities are becoming more important, as are various forms of bilateral and multilateral cooperation. In addition, many of the erstwhile recipients of technical assistance in eastern Europe are now engaged in technical cooperation with CIS states and the Balkans. Technical cooperation is also being strengthened with central banks in other regions, in particular Asia.

The BIS continued to support various regional central bank groups by organising occasional joint events or contributing speakers to their meetings. Last year, that included:

- the South East Asian Central Banks (SEACEN);
- the Centro de Estudios Monetarios Latinoamericanos (CEMLA);
- central banks from eastern Europe and the CIS, through the Joint Vienna Institute;
- the Centre Africain d'Études Supérieures en Gestion (CESAG), which is sponsored by, amongst others, the Central Bank of West African States (BCEAO); and
- the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI).

Communications

The Bank's 75th anniversary in 2005 provided additional opportunities for disseminating information about the role of the BIS since 1930 in seeking to promote international financial cooperation:

- An exhibition ("this is the biz"), inaugurated by Chairman of the Board Nout Wellink on the occasion of the 75th Annual General Meeting, opened for two weeks in July 2005 and was visited by some 6,000 members of the general public. Besides a range of documentation and contemporary illustrations, the exhibition included a filmed interview sequence with central bank Governors and used multimedia to tell the story of the BIS and explain its current functions.
- The complete series of BIS *Annual Reports* was published on DVD, in the Bank's four official languages, providing convenient, searchable access to *Annual Report* content since 1930. The DVD is available for further distribution to libraries and researchers.

In January 2006, the BIS launched a revamped website, providing enhanced access to research by central banks and public speeches by leading central bankers. By May 2006, participation in the web-based Central Bank Research Hub, first launched in 2004, had increased to 40 institutions.

Representative Offices

The Representative Office for Asia and the Pacific (Asian Office) and that for the Americas (Americas Office) serve as platforms for BIS activities in their respective regions. The Offices aim to strengthen relations between the BIS and central banks and supervisory authorities in the regions, on the one hand, and to promote cooperation within each region, on the other. To these ends, the Offices organise meetings, foster the exchange of information and data, and contribute to the Bank's financial and economic research on the regions. Last year, this contribution focused on bond market development, regional currency markets and the management of foreign exchange reserves, resulting in a number of publications.

The Offices also help to deliver BIS banking services in the two regions through regular visits to reserve managers of central banks and meetings at both technical and managerial levels.

Asia-Pacific

The regional treasury dealing room in the Asian Office further enhances banking services to regional customers through its daily trading activities, in support of which two back office staff members were transferred from head office. This dealing room is also taking the lead in managing new Australian dollar products as well as the Bank's own investments in Asian currencies.

The BIS contributed as fund administrator to the establishment and partial public listing of funds under the second Asian Bond Fund (ABF2) initiative of the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP). The 11 EMEAP member central banks have invested international reserves in domestic currency bonds issued by sovereign and quasi-sovereign borrowers in eight EMEAP economies. During the period under review, the BIS supported the transition to a public fund for the ABF Pan-Asia Bond Index Fund and the first ever exchange-traded bond funds for Hong Kong SAR, Malaysia, Singapore and Thailand. In addition, the manager of the ABF1 was transferred to the Asian Office, and economists there continued to support these initiatives with research on Asian bond markets.

Two meetings of the Asian Consultative Council (ACC) responded to BIS Management proposals to strengthen the relationship between Asian shareholding central banks and the Bank. These proposals envisage a three-year research programme, entailing a substantial commitment of staff, a widening of banking services and enhanced work by the Financial Stability Institute supported by a full-time FSI staff member in the Asian Office. The ACC's June 2005 meeting in Basel discussed the broad outline of a new Asian strategy, and the meeting the following February in Shanghai endorsed specific proposals. On the latter occasion, the ACC forwarded to the BIS Board a record of its discussion of Asian central banks' role in the BIS, which had begun at an earlier ACC retreat. Immediately following the February meeting, the Asian central bank Governors met with several Governors from outside Asia for their eighth Special Meeting to review the economic outlook and the development of corporate bond markets.

The Asian Office organised or helped to organise several meetings on monetary policy, financial development and financial stability:

- a meeting on securities regulation for banking supervisors in conjunction with the Financial Stability Institute (May 2005);
- the 10th and 11th meetings of the EMEAP Forum on foreign exchange and other financial markets (June and December 2005);
- a meeting on Asian monetary integration with the Hong Kong Institute for Monetary Research (HKIMR) (October 2005);
- a meeting for central bank reserve managers at the Reserve Bank of Australia in Sydney (October 2005);
- a meeting on Asian monetary policy objectives and implementation with the HKIMR (November 2005);

- a meeting on the development of corporate bond markets with the People's Bank of China in Kunming (November 2005); and
- the fourth meeting of central bank experts on monetary policy operating procedures (March 2006).

The Americas

The focus of activity for the Americas Office during its third year of operation was on expanding its contacts with central banks in the region and cooperating more closely with regional central banking and supervisory authorities. The Office also hosted or supported a series of high-level meetings in Mexico City and elsewhere, sometimes jointly with regional central banks and other institutions. Noteworthy regional activities furthering the Bank's goals were:

- a regional consultative meeting on the CPSS report *General guidance for national payment system development*, held in cooperation with the Central Bank of the Dominican Republic and the Consejo Monetario Centroamericano, in the Dominican Republic (August 2005);
- a joint seminar organised by the FSI and the Association of Supervisors of Banks of the Americas (ASBA) for bank supervisors on "Credit risk under Basel II", in Mexico (September 2005);
- a seminar on "Living with mobile international capital flows" at CEMLA, in Mexico (September 2005);
- a meeting of the Working Party on Monetary Policy in Latin America, in Argentina (October 2005);
- a joint seminar organised by the FSI and CEMLA for bank supervisors on the "Supervisory review process under Basel II", in Argentina (November 2005);
- a high-level meeting on "Evolving banking systems: challenges and implications for monetary policy and financial stability", with a particular emphasis on small open economies, in Jamaica (January 2006);
- a joint seminar organised by the FSI and ASBA on "Validation of IRB systems in Basel II", in Peru (February 2006);
- a regional workshop of the CGFS Working Group on financial stability and local currency bond markets, in Mexico (March 2006); and
- the creation of a virtual secure communication space for central bank lawyers in Latin America on the Bank's eBIS platform.

Financial Stability Institute

The mandate of the Financial Stability Institute (FSI) is to assist financial sector authorities in strengthening their financial systems and to promote financial stability globally. The FSI follows a two-pronged approach designed to disseminate standards and sound practices primarily to the banking and insurance supervision sectors.

The first prong of the FSI approach is the long-standing series of high-level meetings, seminars and conferences both in Basel and at venues around the world. In 2005, the FSI organised a total of 51 events on a broad range of financial sector supervision topics. More than 1,700 representatives of central banks and banking and insurance supervisory agencies participated. These events promote information sharing, the identification of issues and the strengthening of cross-border supervisory contacts. The FSI is also continuing its series of high-level meetings to foster information exchange among heads of supervision in the various regions with regard to Basel II implementation issues and plans. These meetings have also included representatives of commercial banks, thereby helping the supervisory community to stay informed about banks' implementation challenges.

The second prong is FSI Connect, an online information and learning resource for banking supervisors. FSI Connect currently includes more than 100 tutorials covering a wide range of topics for supervisors at all levels of experience and expertise, and new topics are added periodically. In addition, approximately 40 tutorials related to capital and Basel II are being translated into French and Spanish. This will enable FSI Connect to reach a wider audience of banking supervisors globally. More than 120 central banks and supervisory authorities from approximately 105 jurisdictions currently subscribe to FSI Connect, representing nearly 8,000 users.

Promotion of financial stability through the permanent committees

Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision, chaired by Jaime Caruana, Governor of the Bank of Spain, strives to strengthen banking supervisory frameworks and to promote risk management best practices in the banking industry. With effect from 1 July 2006, Jaime Caruana will be succeeded as Chairman by Nout Wellink, President of the Netherlands Bank.

Implementation of the revised capital framework ("Basel II")

Following public consultation and in close collaboration with the International Organization of Securities Commissions (IOSCO), in July 2005 the Committee released some refinements to the treatment of trading activities under Basel II. Additionally, the Committee issued the results of a study on the impact of the Basel II capital framework on regulatory capital requirements. This study had been carried out by banks in most member countries and a number of non-member countries in the fourth quarter of 2005. As a result of the study, the Committee confirmed the 1.06% "scaling factor" to be applied to banks' internal credit rating assessments under the new Basel framework.

Consistent cross-border implementation of Basel II remains one of the key areas of focus for the Committee. In that regard, the Committee's Accord Implementation Group (AIG) has continued to encourage collaboration and consistency. Members of the AIG regularly share experiences as they work with fellow supervisors to establish practical implementation strategies tailored to internationally active banks' operations. To assist this process, the AIG, in conjunction with non-Committee member countries, finalised in June 2006 a guidance paper on effective home-host information sharing under Basel II. The Committee has also published its views on the validation of low-default portfolios, the use of vendor products and operational risk.

Corporate governance for banks

Corporate governance has continued to attract considerable international attention in the light of a number of high-profile breakdowns in governance processes, which led the OECD to publish revised corporate governance principles in 2004. In February 2006, the Basel Committee issued an updated and significantly revised version of its 1999 document *Enhancing corporate governance for banking organisations*, which recognises the banking industry's unique characteristics.

Core Principles for Effective Banking Supervision

In April 2006, the Committee issued for public comment two revised and updated documents, *Core Principles for Effective Banking Supervision* and the associated *Core Principles Methodology*. The Principles were originally published by the Committee in September 1997, and since that time they have been used by countries and external assessors as a benchmark for the quality of national supervisory systems. The Methodology, first issued in 1999, is designed to improve objectivity and comparability in the assessment of different countries' compliance with the Core Principles. Since 1997, significant changes have occurred in banking regulation, much experience has been gained with implementing the Core Principles in individual countries, and new regulatory issues have emerged. A wide range of users and experts have been involved in drafting the revised versions.

Accounting and auditing

Over the past year, the Committee's efforts have focused on contributing to the development of international accounting and auditing standards. High-level dialogue with standard setters and industry leaders in these areas is helping the Committee to gain well informed perspectives and heighten sensitivity towards supervisory concerns over accounting and auditing issues early in the standards development process.

The Committee has formulated specific guidance addressing prudential concerns for banks electing to adopt the recently issued International Accounting Standards Board (IASB) fair value option for valuing financial instruments. A paper was published providing guidance on sound credit risk assessment and valuation for loans, which considers how common data and processes can be used for credit risk assessment, accounting and capital adequacy purposes. Finally, the Committee has submitted comments addressing revised international auditing standards and has contributed to the development of audit oversight bodies.

Increasing the involvement of non-member countries in the Basel Committee process

Since May 2006, the Committee's agendas, action points and working documents have also been distributed to the chairs of the regional supervisory groups for circulation within the groups at their discretion. The Committee is closely involved in the organisation of the next International Conference of Banking Supervisors, which will take place in Mexico in October 2006. In addition, it has materially increased the amount of information about its activities on the BIS public website.

Committee on the Global Financial System

The Committee on the Global Financial System (CGFS) meets four times a year, and is mandated to monitor developments in global financial markets and report to the central bank Governors of the G10 countries. The members of the CGFS also undertake coordinated longer-term projects by forming study groups or working groups that address topics of particular interest in the area of financial market developments. The members of the CGFS include senior officials from G10 central banks and the ECB, and representatives of a number of central banks from major economies and financial centres.

Monitoring discussions

The Committee's monitoring discussions, which focused on macroeconomic and financial market developments during the past year, covered the following issues:

- implications for the global economy arising from a turn in the credit cycle and from rising commodity prices;
- implications of the widespread tightening of monetary policy for banks in emerging market economies;
- the build-up of foreign exchange reserves in many emerging economies and its domestic implications;
- the decline in long-term bond yields, the role of pension funds in that process and its implications;
- the impact of Hurricane Katrina on the global reinsurance industry;
- the compression of emerging market yield spreads and identification of factors that might have played a role;
- the sources and implications of the recent rise in merger and acquisition activity; and
- the reasons for the weakness of corporate investment in a number of economies.

Working groups and other projects

In January 2006 the Committee published a report on *Housing finance in the global financial market*, from a working group that studied structural factors influencing the supply of and demand for housing finance. The working group's main conclusions were as follows: first, the developments in the housing finance market have led to an improved allocation and pricing of credit that has enhanced financial and macroeconomic stability; second, stress tests conducted by central banks and others indicate that the current level of debt is affordable and that the majority of borrowers would be able to absorb plausible declines in house prices and higher interest rates; finally, the fact that housing loans are increasingly funded in capital markets may result in stronger links between global financial market developments and domestic housing markets than observed in the past.

The CGFS is currently working on the following projects:

- organising a workshop with market participants to discuss the structural changes taking place in credit markets, and to understand the supply and demand factors driving these developments;
- a study group on volatility to understand the factors contributing to the recent low volatility in financial markets, driven by concern that this might encourage financial players to take excessive risk, with potential implications for financial stability;
- a working group on financial stability and local currency bond markets to review how far the issuance of local currency debt improves domestic financial intermediation, and what financial stability implications these developments might have; and
- a working group on institutional investors to analyse the influence of changing regulatory and accounting standards and structural reforms of public pension systems on institutional investors' asset allocation and risk-taking decisions.

Committee on Payment and Settlement Systems

The Committee on Payment and Settlement Systems (CPSS) contributes to strengthening financial market infrastructure by promoting sound and efficient payment and settlement systems. During the period under review, the Committee further enhanced its cooperation with other international institutions and groupings, and involved an increasingly wide group of central banks in its activities. Timothy F Geithner, President and Chief Executive Officer of the Federal Reserve Bank of New York, is Chairman of the Committee.

In May 2005, the Committee published reports on *Central bank oversight of payment and settlement systems* and *New developments in large-value payment systems*. In January 2006, it released a report on *Cross-border collateral arrangements*, and one on *General guidance for national payment system development*. This last report benefited greatly from input received following the release of a consultative version of the report in May 2005.

In February 2006, the Committee announced that it would conduct a survey of how banks and other selected institutions manage the risks they can incur when settling foreign exchange transactions. The survey took place during the second quarter of this year and was based on those carried out in 1996 and 1997, the results of which were reported in *Reducing foreign exchange settlement risk: a progress report*. The latest survey was updated to reflect the significant developments in settlement practices that have since taken place.

In March 2006, the Committee and the World Bank issued a consultative report on *General principles for international remittance services*. The report provides an analysis of the payment system aspects of remittances, on the basis of which it sets out general principles designed to assist countries that wish to improve the market for remittance services. The report contains five general principles covering transparency and consumer protection; payment system infrastructure; the legal and regulatory framework; market structure and competition; and governance and risk management.

The Committee continued to enhance its cooperation with other central banks, particularly those of emerging market economies, in order to extend its work outside the G10. It also provided support and expertise to workshops and seminars on payment system issues organised by the BIS in cooperation with regional central banking organisations.

Markets Committee

The Markets Committee brings together senior G10 central bank officials responsible for market operations. Its bimonthly meetings provide an opportunity for participants to exchange views on recent developments and structural changes in foreign exchange and related financial markets, as well as to consider the short-run implications of particular current events for the functioning of these markets. The Committee invites representatives from major countries to join the discussions on a regular basis; in addition to the central banks and monetary authorities of Australia, Brazil, China, Hong Kong SAR, Korea, Mexico, Singapore and Spain, the Reserve Bank of India participated for the first time in early 2006.

Issues covered in the meetings included:

- the recent movements in the major bilateral exchange rates and the impact of the changing assessments of the outlook for monetary policy in the three largest currency areas;
- the implications of the new exchange rate arrangements in China;
- the influence of the growth of electronic trading platforms on the functioning of forex markets;
- the challenges posed by the low-volatility environment;
- the factors behind the recent rise in the price of commodities, in particular gold;
- the movements in bond yields in the major financial markets, with a focus on the role played by supply and demand factors (including the influence of institutional investors and the impact of changes in pension fund regulatory arrangements), as well as on the more varied performance across the credit spectrum; and
- the impact on financial markets of foreign exchange reserve accumulation.

Members also discussed a number of specific topics over the course of the year, including the preparations for the next Triennial Central Bank Survey of Foreign Exchange and Derivatives Market Activity in April 2007, business continuity challenges for central banks, and various monetary policy implementation issues. With effect from 1 June 2006, Sheryl Kennedy, Deputy Governor of the Bank of Canada, was succeeded by Hiroshi Nakaso, Director General of the Bank of Japan, as Chair of the Markets Committee.

Central Bank Counterfeit Deterrence Group

The Central Bank Counterfeit Deterrence Group (CBCDG) is mandated by the Governors of the G10 central banks to investigate emerging threats to the security of banknotes and to propose solutions for implementation by the issuing authorities. The CBCDG has developed anti-counterfeiting features to prevent banknote images from being replicated by colour copiers and digital technology (personal computers, printers and scanners). The BIS supports the work of the CBCDG by hosting its Secretariat and acting as its agent in contractual arrangements.

BIS contributions to broader international financial cooperation

Group of Ten

The Bank contributes actively to the work of the G10 Finance Ministers and central bank Governors, their Deputies and the activities taking place under their auspices. It participates in meetings as an observer institution and provides secretariat support to the G10 together with the IMF and OECD.

In September 2005, a report prepared at the request of the G10 Deputies on the implications of ageing populations and pension system reform for financial markets and economic policies was released. It concluded that changes under way in public and private pension schemes may significantly increase the influence of retirement saving and related capital flows in financial markets. The report recommended that regulatory and supervisory arrangements should aim to influence and support the trend towards more rigorous risk management, greater transparency and better governance at private pension funds, for example by ensuring consistency between funding and prudential requirements and accounting standards. Tax rules should not hinder the build-up of funding buffers by private pension funds, but should avoid the abuse of tax deferrals. In addition, as risks are increasingly shifted to individual households, financial education and advice may need to be strengthened, in order to protect pension beneficiaries. Work was also undertaken on safeguarding critical functions performed by private financial institutions.

Financial Stability Forum

The Financial Stability Forum (FSF), established in 1999, promotes international financial stability through enhanced information exchange and cooperation in financial supervision and surveillance. Its principal remit is to assess conjunctural and structural vulnerabilities affecting the international financial system and to encourage and coordinate action to address them. The FSF comprises senior officials from finance ministries, central banks and financial regulators in key financial centres, as well as representatives of international financial institutions (the BIS, IMF, OECD and World Bank), international supervisory and regulatory standard-setting bodies (Basel Committee, IAIS, IASB and IOSCO) and central bank expert groupings (CGFS and CPSS). The Forum's Secretariat is based at the BIS. More information on the FSF is available at www.fsforum.org.

The FSF meets twice yearly in plenary form, most recently in September 2005 in London and March 2006 in Sydney. The Forum also holds regional meetings to foster wider exchanges of views on financial vulnerabilities and the work under way nationally and internationally to address them. Recent regional meetings were held in Mexico City in November 2005, focusing on the Latin American economies, and in Sydney in March 2006, focusing on the Asia-Pacific region.

In the past year, in addition to its regular assessment of financial vulnerabilities, the FSF also examined the preparedness of major financial institutions to deal with major changes in the economic and financial environment; the lessons of past episodes of market liquidity erosion; business continuity principles for financial firms and authorities; the potential economic and financial stability implications of an avian flu pandemic; progress in the implementation of international standards and codes; the robustness of international financial standard-setting processes; and concerns about regulatory overload.

The rapid growth of the hedge fund sector in recent years has attracted attention in markets and in the official community. In November 2005, the FSF convened two informal workshops, attended by senior members of the hedge fund community, their counterparties and financial authorities, with the aim of improving understanding between the official and private sectors on issues relating to hedge funds. The workshops discussed trends in the sector, risks in the present market environment, risk management challenges for hedge funds and their counterparties, and operational issues.

The FSF also supported efforts to strengthen international accounting and auditing standards and practices, including by fostering dialogue among stakeholders in this area. In February 2006, the FSF, the International Accounting Standards Board and the International Federation of Accountants organised a roundtable that addressed experiences in the first year of implementation of the International Financial Reporting Standards (IFRS); the convergence process between the IASB and other national accounting standard setters; fair value accounting issues; and risks in the financial reporting process. The roundtable brought together senior representatives from national authorities with responsibility for financial reporting, accounting and auditing professional organisations, standard setters, market participants (including representatives from capital market firms, corporations and investors), international regulatory bodies and international financial institutions.

In March 2005, the FSF set in train a process to promote further improvements in offshore financial centres (OFCs), drawing on initiatives by FSF members at both international and national level and appropriate steps by the FSF itself. As part of this process, the FSF set up a group to review the results of work being carried out by FSF member bodies to ensure that OFCs meet international standards and to address remaining problems in several OFCs, notably in the areas of effective cross-border cooperation, information exchange and adequacy of supervisory resources. The review group held its first formal meeting in February 2006 and subsequently reported to the full FSF on progress in these areas.

At the end of April 2006, Roger W Ferguson Jr stepped down as Chairman of the FSF upon his departure from the Federal Reserve. He was succeeded by Mario Draghi, Governor of the Bank of Italy.

International Association of Insurance Supervisors

The IAIS has been hosted by the BIS since the establishment of its Secretariat in January 1998. Its role is akin to that of the Basel Committee on Banking Supervision, but focused on the insurance sector. The IAIS aims at contributing to global financial stability through improved supervision of the insurance industry, the development of standards for supervision, international cooperation based on exchange of information, and mutual assistance. In collaboration with other international regulatory bodies (within the framework of the Joint Forum of the Basel Committee, IOSCO and the IAIS), the IAIS has also helped develop principles for the supervision of financial conglomerates. Moreover, it actively participates in the Financial Stability Forum. The continuous increase in new members and observers reflects the recognition of the IAIS's role. More information on the IAIS is available at www.iaisweb.org.

During the past year, the IAIS undertook several key initiatives in the development and harmonisation of insurance standards concomitant with the changing financial landscape, the priority areas being accounting, capital adequacy and solvency, and reinsurance.

In the area of accounting, June 2005 saw the release of the paper *Issues arising as a result of the IASB's insurance contracts project – Phase II: initial IAIS observations*. The paper provides initial observations on identified measurement themes common to both financial and regulatory reporting that the IAIS believes the IASB should address in its consideration of Phase II of its insurance contracts project, notably regarding the valuation of insurance liabilities.

Regarding capital adequacy and solvency, in October 2005 the IAIS approved a policy paper entitled *A new framework for insurance supervision: towards a common structure and common standards for the assessment of insurer solvency* (the Framework paper), describing the rationale and the contents of a framework for insurance supervision. At the same time, the IAIS adopted *Towards a common structure and common standards for the assessment of insurer solvency: cornerstones for the formulation of regulatory financial requirements* (the Cornerstones paper), which sketches the contours of the common structure and standards, highlighting some of the critical cornerstones for the formulation of regulatory financial requirements. In February 2006, another overarching standard-setting paper, *Roadmap for a common structure and common standards for the assessment of insurer solvency*, was released, setting out the work plan for future efforts in establishing the new framework for insurance supervision.

Also in October 2005, the IAIS approved a supervisory *Guidance paper on risk transfer, disclosure and analysis of finite reinsurance*. In December, the IAIS published its second annual *Global reinsurance market report*, based on global reinsurance market statistics for the financial year 2004. The report reviews the overall financial health of the sector during 2004, during which it was able to withstand a number of natural catastrophes, including four major hurricanes in the United States and typhoons in Japan. It also briefly discusses loss-causing events in 2005 – in particular Hurricane Katrina, the impact of which fell heavily on the reinsurance sector – concluding that while reinsurer earnings will have been substantially reduced there will not be any significant adverse impact on the reinsurance sector's overall capital.

Training remains a high priority for the IAIS. During the past year, the IAIS organised or assisted in 20 seminars, conferences and workshops around the world, in several cases in collaboration with the Financial Stability Institute. At the same time, the Association, along with the World Bank, carried forward the insurance core curriculum project, developing some 25 high-quality modules for in-depth application of the IAIS core principles.

International Association of Deposit Insurers

The International Association of Deposit Insurers (IADI) was established in May 2002 and opened its Head Office at the BIS in October that year. Currently, 61 organisations (of which 44 are members) from around the world are involved in the activities of IADI, including a number of central banks that have an interest in promoting the adoption or operation of effective deposit insurance systems. The Chair of the Executive Council and President of IADI is Jean Pierre Sabourin and the Secretary General is John Raymond LaBrosse.

During its fourth year, IADI continued to provide a forum to facilitate wide international contacts among deposit insurers and other interested parties. For example, its Fourth Annual Conference, held in Taipei in September 2005, was attended by 150 deposit insurers and policymakers from 49 countries; the conference theme was "Challenges for deposit insurers in resolving bank failures".

IADI also organised the first ever International Week of Deposit Insurance, with a special exhibition at which 32 exhibitors provided information on the key characteristics of depositor protection arrangements in countries around the world. Another new initiative was the Deposit Insurance Organization of the Year Award, conferred on a member institution in celebration of an important achievement and/or in recognition of the contribution that the member has made to the furtherance of IADI's objects.

Work is continuing on guidance to improve the effectiveness of deposit insurance systems. The Association has published guidance papers on:

- the establishment and design of deposit insurance systems;
- the development of differential premium systems;
- the promotion of effective interrelationships among financial safety net participants; and
- general guidance on its *Bank resolutions consultation paper*.

Recent regional activities included conferences, seminars and Committee meetings in Almaty, Cartagena, Manila, Abuja, Taipei, Prague and Marrakesh. IADI also collaborated with the Asian Development Bank on an international seminar "Integrating financial supervision and the role of deposit insurers" in February 2006.

The website (www.iadi.org) and a bimonthly newsletter provide information on activities to members and participants.

Financial services of the Bank

Banking services

The BIS offers a wide range of financial services designed specifically to assist central banks and other official monetary authorities in the management of their foreign reserves. Some 130 such authorities, as well as a number of international institutions, currently make active use of these services.

Safety and liquidity are the key features of the Bank's credit intermediation services, which are supported by a rigorous internal risk management framework. In accordance with best practice, a separate risk control unit reporting directly to the Deputy General Manager – and through him to the General Manager – monitors the Bank's credit exposure, liquidity, and market and operational risks.

In response to the diverse – and constantly evolving – needs of central banks, the BIS offers an extensive array of investment possibilities in terms of currency denomination, liquidity and maturity. In addition to traditional money market placements such as sight/notice accounts and fixed-term deposits, the Bank offers two instruments that can be traded (bought and sold back) directly with it: the Fixed-Rate Investment at the BIS (FIXBIS), available in maturities from one week to one year; and the BIS Medium-Term Instrument (MTI), with maturities from one to 10 years. A series of callable MTI structures, as well as other instruments with embedded optionality, are also part of the standard product range.

The Bank transacts foreign exchange and gold on behalf of its customers. From time to time, it extends short-term credits to central banks, usually on a collateralised basis. The BIS also acts as trustee and collateral agent (see below).

The BIS provides asset management services in sovereign securities or high-grade assets. These may take the form of either a specific portfolio mandate negotiated between the BIS and a central bank or an open-end fund structure – the BIS Investment Pool (BISIP) – allowing customers to invest in a common pool of assets. The two Asian Bond Funds (ABF1 and ABF2) are administered by the BIS under the BISIP umbrella: ABF1 is managed by the BIS and ABF2 by a group of external fund managers.

BIS financial services are provided out of two linked trading rooms: one at its Basel head office and one at its Asian Office in Hong Kong SAR.

Operations of the Banking Department in 2005/06

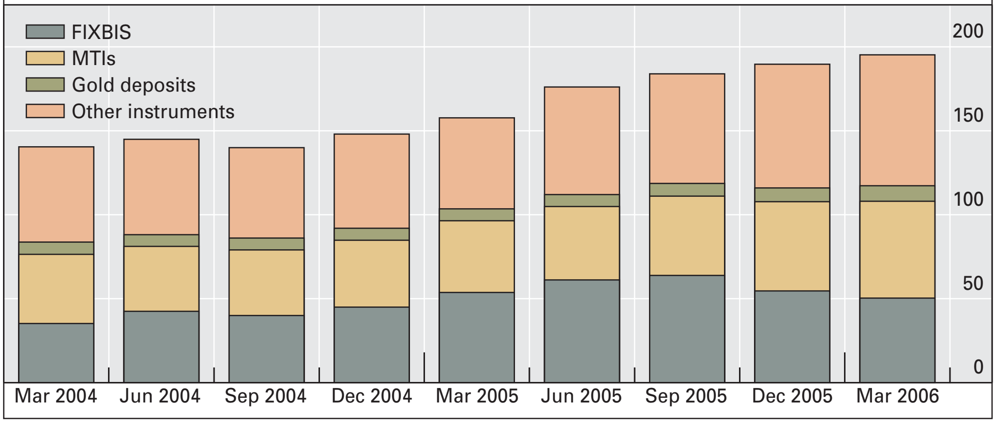
The BIS balance sheet continued to expand in 2005/06 to reach a financial year-end record at 31 March 2006 of SDR 220.1 billion, representing a substantial year-on-year increase of SDR 39.6 billion or 22%. Of this increase, SDR 2.7 billion was attributable to changes in exchange rates, notably the appreciation of the US dollar against the SDR, and SDR 3.7 billion was attributable to a higher market price of gold.

Liabilities

The size of the BIS balance sheet is mainly driven by placements from customers, which constitute the lion's share of total liabilities. On 31 March

Customer placements, by product

SDR billions



2006, customer placements (excluding repurchase agreements) amounted to SDR 195.2 billion, compared with SDR 157.7 billion at the end of the previous financial year.

Some 95% of customer placements are denominated in currencies, with the remainder in gold. Currency deposits rose from SDR 150.6 billion a year earlier to SDR 186.0 billion at end-March 2006, representing around 6% of the world's total foreign currency reserves. The share of currency placements denominated in US dollars was 65%, while euro-denominated funds accounted for 20%. The increase in gold deposits from SDR 7.1 billion to SDR 9.2 billion was mainly due to valuation effects, ie a higher gold price.

The expansion in customer placements was mainly driven by fixed-term deposits and MTIs. Subscriptions to MTIs increased by 35%, making them the single largest BIS instrument held by customers. Growth of more than 40% in fixed-term deposits partly reflected a shift from FIXBIS, a more liquid but lower-yielding instrument.

A geographical breakdown of currency placements with the BIS shows a relative shift from Asian customers to those in other parts of the world, particularly Europe.

Assets

Most of the BIS assets consist of investments with top-quality commercial banks of international standing as well as government and quasi-government securities, including reverse repurchase agreements. In addition, the Bank owns 165 tonnes of fine gold, having disposed of 15 tonnes during the financial year. The credit exposure is managed in a very conservative manner, with 99.7% of the Bank's credit exposure rated A– or higher as at 31 March 2006 (see note 4E to the financial statements).

The Bank's holdings of currency deposits and securities, including reverse repurchase agreements, totalled SDR 199.2 billion on 31 March 2006, up from SDR 165.4 billion at the end of the previous financial year. These additional funds were mainly invested in Treasury bills, time deposits with banks, and debt securities issued by commercial banks.

The Bank uses various derivative instruments in order to manage its assets and liabilities efficiently (see note 9 to the financial statements).

Functions as agent and trustee

Trustee for international government loans

The Bank continued to perform its functions as trustee for the funding bonds 1990–2010 of the Dawes and Young Loans during the year (for details, see the *63rd Annual Report* of June 1993). The Deutsche Bundesbank as paying agent notified the Bank that in 2005 the Bundeswertpapierverwaltung (BWV – German Federal Securities Administration) had arranged for payment of approximately €4.9 million for redemption of funding bonds and interest. Redemption values and other details were published by the BWV in the *Bundesanzeiger (Federal Gazette)*.

The Bank maintained its reservations regarding the application by the BWV of the exchange guarantee clause for the Young Loan (stated in detail in its *50th Annual Report* of June 1980), which also extend to the funding bonds 1990–2010.

Escrow agent functions

Within the context of an external debt agreement reached in October 2005 between the Federal Republic of Nigeria and its 15 Paris Club creditor countries, the BIS entered into a Depository and Escrow Agreement with the Central Bank of Nigeria dated 31 October 2005, holding funds and releasing them to each creditor country once the relevant bilateral debt restructuring agreements with Nigeria had been concluded.

Collateral agent functions

Under a number of agreements, the BIS acts as collateral agent to hold and invest collateral for the benefit of the holders of certain foreign currency denominated bonds issued by countries under external debt restructuring arrangements. During 2005/06, collateral pledge agreements included those for Brazilian bonds (described in detail in the *64th Annual Report* of June 1994), Peruvian bonds (see the *67th Annual Report* of June 1997) and Côte d'Ivoire bonds (see the *68th Annual Report* of June 1998).

Institutional and administrative matters

Changes to the BIS governance structure

In 2004, the BIS undertook a review of its governance to determine the extent to which it was consistent with current principles of sound corporate governance, taking due account of the specific features of the Bank as an international organisation (see the *75th Annual Report* of June 2005).

The review was conducted by three leading independent corporate governance experts: Professor Klaus J Hopt, Director of the Max Planck

Institute for Foreign Private and Private International Law in Hamburg; Professor Reinier H Kraakman, Harvard Law School; and Professor Jean-Victor Louis, former General Counsel of the National Bank of Belgium and Emeritus Professor at the Université Libre de Bruxelles.

The experts submitted their final report to the BIS Board of Directors in November 2004. The report, available on the BIS website, identified some possibilities for improving the Bank's Statutes and its governance practice. A committee composed of selected Board members was created, to discuss the matters raised in the report and to make proposals for concrete action. The committee recommended a number of amendments to the BIS Statutes to improve the Bank's corporate governance and increase its transparency. The amendments were approved by the Board and adopted at an Extraordinary General Meeting of the Bank on 27 June 2005.

The Bank's administration

Budget policy

The process of formulating the Bank's expenditure budget for the next financial year starts about six months in advance with the setting by the BIS management of a broad business orientation and financial framework. Within this context, business areas specify their plans and the corresponding resource requirements. The process of reconciling detailed business plans, objectives and overall resource availability culminates in the determination of a draft financial budget. This must be approved by the Board before the start of the financial year.

In drawing up the budget, a distinction is made between administrative and capital expenditures. In common with other organisations of a similar nature to the BIS, management and staff expense, including remuneration, pensions and health and accident insurance, amounts to around 70% of administrative costs. The other major expenditure categories, each accounting for around 10% of administrative spending, are IT and telecommunications and building and equipment expenditure. Capital spending mainly relates to building and IT investment expenditure, and can vary significantly from year to year. Most of the Bank's administrative and capital expenditure is incurred in Swiss francs.

Administrative expenses before depreciation during the financial year 2005/06 amounted to 223.6 million Swiss francs, 1.2% below the budget of 226.3 million Swiss francs,[1] while capital expenditure, at 23.8 million Swiss francs, was 3.2 million below budget. The underspending in administrative expenses was primarily attributable to the initial headcount savings from the Bank's activity review (see below), which led to lower expenditure on management and staff costs. As regards capital spending, the largest items of

1 The Bank's budgetary accounting is cash-based and excludes certain financial accounting adjustments, principally relating to post-employment benefit obligations, which take into account financial market and actuarial developments. These additional factors are included under "Operating expense" disclosed in the profit and loss account (see "Net profit and its distribution").

expenditure related to the enhancement of the Bank's physical security systems and building safety.

Expenditure in 2005/06 was the closest to the budget achieved in the past few years, and reflected further improvement in budgetary management, which was attributable to tighter budgeting and the enhancement of the quarterly monitoring of the objectives in business area plans that was introduced in 2004/05. In addition to these measures, Management undertook a thorough review of the Bank's activities during the year, which identified a number of areas where efficiency gains and headcount savings could be realised.

Administrative and capital expenditure also reflected the priorities set in the 2005/06 budget of strengthening the Bank's risk management, internal audit and compliance functions, and of continuing the efforts to improve security arrangements.

In March 2006, the Board approved an increase in the administrative budget for the financial year 2006/07 of 2.5% to 232.0 million Swiss francs. The capital budget foresees a decrease of 1.1 million Swiss francs to 25.9 million. The budgets for 2006/07 are based on the main objectives of the Bank for the next financial year, which are to:

- expand BIS services to deepen relations with shareholders in the Asia-Pacific region. This initiative includes a three-year policy-oriented research programme on monetary and financial sector issues in Asia and further enhancement of banking services in the Asian time zone;
- implement the recommendations arising from the activity review undertaken during 2005/06. The first phase will lead to a reduction of administrative positions in Basel, thereby providing the room for manoeuvre to pursue the Asian initiative within a restrained budgetary framework; and
- plan for further renewal of meeting facilities at the Tower building in Basel and the renovation of the Sports Club buildings.

Remuneration policy

The jobs performed by BIS staff members are assessed on the basis of a number of objective criteria, including qualifications, experience and responsibilities, and are classified into distinct job grades. The job grades are associated with a structure of salary ranges. Regular salary surveys are conducted in which the structure of BIS salaries is assessed against that in comparable institutions or market segments. The analysis takes into account differences in the taxation of salaries of the staff of the surveyed institutions. When applying the market data to BIS salaries, the Bank focuses on the upper half of market salaries in order to attract highly qualified staff.

In those years in which no comprehensive salary survey is undertaken, the salary structure is adjusted for the rate of inflation in Switzerland and the average rise in real salaries in the business sector of major industrial countries. In July 2005, the salary structure was increased by 1.2%. Movements of salaries of individual staff members within the ranges of the salary structure are based on merit, subject to a regular evaluation of performance.

Non-Swiss and non-locally hired staff, including senior management, are entitled to an expatriation allowance. This currently amounts to 14% or 18%

of annual salary depending on family status, subject to a ceiling. Expatriate staff are also entitled to receive an education allowance.[2] In addition, BIS staff members have access through the Bank to health insurance and a defined benefit contributory pension plan.

With regard to the remuneration of senior officials, it was decided in early 2005 to conduct regular surveys to benchmark their salaries against conditions in comparator institutions. Between surveys, salaries of senior officials are adjusted for Swiss inflation. As of 1 July 2005, the annual remuneration of senior managers before expatriation allowances is based on the following salary structure:

- General Manager 718,370 Swiss francs
- Deputy General Manager 607,850 Swiss francs
- Heads of Department 552,590 Swiss francs

In addition to the above, the General Manager receives an annual representation allowance and enhanced pension rights.

The Annual General Meeting approves the remuneration of members of the Board of Directors, with adjustments taking place every three years. The most recent adjustment took place on 1 July 2005, bringing the overall fixed annual remuneration paid to the Board of Directors to a total of 895,800 Swiss francs. In addition, Board members receive an attendance fee for each Board meeting in which they participate. Assuming the full Board is represented in all Board meetings, the annual total of these attendance fees amounts to 824,160 Swiss francs.

Net profit and its distribution

Net profit

The net profit for the 76th financial year amounted to SDR 599.2 million, compared with the equivalent figure for the preceding year of SDR 370.9 million. The factors behind this outcome are discussed below.

Total operating income

Total operating income amounted to SDR 573.4 million in the financial year 2005/06, compared with SDR 458.4 million in 2004/05. There were three principal reasons for this development:

- Inflows from share subscriptions and retained profits increased the component of the Bank's equity denominated in currencies, and consequently generated additional interest income from the Bank's investment securities. Interest income from investment securities also benefited from rising interest yields.
- Net income from the Bank's deposit-taking business rose as a result of the strong inflow of deposits from customers during the financial year. Intermediation margins in 2005/06 were almost unchanged from 2004/05.

[2] Certain staff members who joined the Bank before 1997 receive an expatriation allowance of 25%, but are not entitled to receive education allowances.

- Foreign exchange losses were incurred in both financial years, but at SDR 25.2 million in 2005/06 they were SDR 9.3 million lower than in 2004/05. The exchange loss in 2005/06 resulted principally from the impact of an appreciating gold price on the market value of forward contracts for the sale of gold investment assets.[3]

Operating expense

Operating expense (see note 28 to the financial statements) amounted to SDR 146.9 million, 1.3% above the preceding year's figure of SDR 145.0 million. Administrative expenses before depreciation amounted to SDR 133.6 million, 3.3% above the previous year's figure of SDR 129.3 million. The depreciation charge decreased from SDR 15.7 million to SDR 13.3 million.

Operating profit and other profit items

The Bank's operating profit, which reflects the profits of its ongoing business, amounted to SDR 426.5 million, 36.1% higher than the equivalent figure of SDR 313.4 million recorded in 2004/05.

A net gain of SDR 58.2 million was incurred on the sale of investment securities during the year. This resulted from the realignment of the Bank's investment portfolio to its underlying benchmark position and reflected the sale of securities acquired when interest rates were higher.

The realised gain of SDR 114.5 million on sales of gold investment assets during 2005/06 arose from the sale of 15 tonnes from the Bank's total holdings of 180 tonnes at 31 March 2005.

Review of dividend policy

During the year, the Board reviewed the Bank's dividend policy, taking into consideration the Bank's capital needs and the interests of BIS shareholders in obtaining a fair and sustainable return on their investments in BIS shares. Having examined the outlook for the Bank's profits, the Board concluded that the current approach of increasing the dividend by SDR 10 each year would be broadly consistent with these considerations. This approach would result in an increase in the dividend from SDR 235 per share in 2004/05 to SDR 245 in 2005/06.

The Board also decided to review the dividend policy every two to three years, taking changing circumstances into account where necessary.

Proposed distribution of the net profit for the year

On the basis of Article 51 of the Statutes, the Board of Directors recommends that the net profit of SDR 599.2 million for the financial year 2005/06 be applied

[3] The exchange loss of SDR 34.5 million in 2004/05 resulted from the impact of the appreciation of the Swiss franc against the SDR during 2004 on the excess of Swiss franc liabilities over assets in that currency that existed before the repurchased shares of the Belgian and French issues were sold back to the respective central banks in autumn 2004.

by the General Meeting in the following manner:

1. SDR 132.4 million in payment of a dividend of SDR 245 per share;
2. SDR 46.7 million to be transferred to the general reserve fund;[4]
3. SDR 6.0 million to be transferred to the special dividend reserve fund; and
4. SDR 414.1 million, representing the remainder of the available net profit, to be transferred to the free reserve fund. This fund can be used by the Board of Directors for any purpose that is in conformity with the Statutes.

If approved, the dividend will be paid on 3 July 2006 according to each shareholder's instructions in any constituent currency of the SDR, or in Swiss francs, to the shareholders whose names were contained in the Bank's share register on 31 March 2006. The proposed dividend of SDR 245 per share for the financial year 2005/06 represents a 4.3% increase over the dividend for 2004/05.

The full dividend will be paid on 510,192 shares. The dividend payable in respect of the 35,933 treasury shares of the American issue that were redistributed on 31 May 2005 will be settled on a pro rata basis from that date. The number of issued and paid-up shares is 547,125. Of these shares, 1,000 were held in treasury at 31 March 2006, namely the suspended shares of the Albanian issue. No dividend will be paid on these treasury shares.

Report of the auditors

The Bank's financial statements have been duly audited by Deloitte AG, who have confirmed that they give a true and fair view of the Bank's financial position at 31 March 2006 and the results of its operations for the year then ended. Their report is to be found immediately following the financial statements.

[4] Since the general reserve fund exceeded four times the Bank's paid-up capital at 31 March 2005, Article 51 of the Bank's Statutes requires that 10% of the profit after payment of the dividend shall be paid into this fund, until its balance equals five times the paid-up capital.

Board of Directors

Jean-Pierre Roth, Zurich
Chairman of the Board of Directors

Hans Tietmeyer, Frankfurt am Main
Vice-Chairman

Ben S Bernanke, Washington
Pierluigi Ciocca, Rome
David Dodge, Ottawa
Mario Draghi, Rome
Toshihiko Fukui, Tokyo
Timothy F Geithner, New York
Lord George, London
Stefan Ingves, Stockholm
Mervyn King, London
Jean-Pierre Landau, Paris
Christian Noyer, Paris
Guy Quaden, Brussels
Alfons Vicomte Verplaetse, Brussels
Axel A Weber, Frankfurt am Main
Nout H E M Wellink, Amsterdam

Alternates

Giovanni Carosio or Ignazio Visco, Rome
Karen H Johnson, Washington
Peter Praet or Jan Smets, Brussels
Wolfgang Mörke, Frankfurt am Main
Marc-Olivier Strauss-Kahn or Michel Cardona, Paris
Paul Tucker or Paul Fisher, London

Committees of the Board of Directors

Consultative Committee
Audit Committee

both chaired by Hans Tietmeyer

Senior officials

Malcolm D Knight	General Manager
Hervé Hannoun	Deputy General Manager
Peter Dittus	Secretary General, Head of Department
William R White	Economic Adviser, Head of Monetary and Economic Department
Günter Pleines	Head of Banking Department
Daniel Lefort	General Counsel
Már Gudmundsson	Deputy Head of Monetary and Economic Department
Jim Etherington	Deputy Secretary General
Louis de Montpellier	Deputy Head of Banking Department
Josef Tošovský	Chairman, Financial Stability Institute

Changes among the Board of Directors and senior officials

At the Extraordinary General Meeting held on 27 June 2005, it was decided to abolish the position of President of the BIS. Nout Wellink, President of the Netherlands Bank, who had been re-elected as Chairman of the Board of Directors and President of the BIS with effect from 1 March 2005, continued to serve in his capacity as Chairman of the Board before stepping down on 28 February 2006. At its meeting in January 2006, the Board elected Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank, as Chairman of the Board of Directors for a period of three years commencing on 1 March 2006.

On 7 November 2005, the term of office of Vincenzo Desario, Director General of the Bank of Italy, as a member of the Board of Directors came to an end. Following the resignation of Antonio Fazio as Governor of the Bank of Italy on 19 December 2005 and pending the start of the term of office of the new Governor of the Bank of Italy, Mr Desario assumed the role of Acting Governor of the Bank of Italy and became an ex officio Director of the BIS from 20 December 2005 until 15 January 2006. By letter dated 23 December 2005, Mr Desario appointed Pierluigi Ciocca, Deputy Director General of the Bank of Italy, as a member of the Board to fill the seat vacated by Mr Desario, for a period of three years ending on 22 December 2008. On 16 January 2006, Mario Draghi was appointed Governor of the Bank of Italy and became an ex officio Director of the Board of Directors.

At the end of December 2005, Lars Heikensten resigned from his position as Governor of Sveriges Riksbank and vacated his seat on the Board. At its meeting in November 2005, the Board elected Stefan Ingves, the successor to Mr Heikensten at Sveriges Riksbank, as a member of the Board from 1 January 2006 for the unexpired period of Mr Heikensten's term of office, ie until 31 March 2008. At the same meeting, Axel Weber, President of the Deutsche Bundesbank, reappointed Hans Tietmeyer as a member of the Board of Directors for a further period of three years ending on 31 December 2008, and the Board re-elected Hans Tietmeyer as Vice-Chairman of the Board of Directors from 1 January 2006 until the end of his term of office as a member of the Board.

On 1 February 2006, Ben S Bernanke succeeded Alan Greenspan as Chairman of the Board of Governors of the Federal Reserve System and became an ex officio Director of the Board of Directors. With effect from 1 March 2006, Guy Quaden, Governor of the National Bank of Belgium, reappointed Alfons Verplaetse as a member of the Board of Directors for a further period of three years ending on 28 February 2009.

On 31 December 2005, Hervé Hannoun resigned from his position as First Deputy Governor of the Bank of France and vacated his seat on the Board. On 27 April 2006, Christian Noyer, Governor of the Bank of France, appointed Jean-Pierre Landau as a member of the Board of Directors to fill the seat vacated by Hervé Hannoun for the unexpired period of Mr Hannoun's term of office, ie until 27 November 2006.

Axel Weber, President of the Deutsche Bundesbank, appointed Wolfgang Mörke as his second Alternate from July 2005 to succeed Stefan Schönberg. Mario Draghi, Governor of the Bank of Italy, appointed Giovanni Carosio as his first Alternate and Ignazio Visco as his second Alternate from January 2006.

As regards the senior officials of the Bank, upon the retirement of André Icard, Hervé Hannoun was appointed Deputy General Manager of the BIS from 1 January 2006. Daniel Lefort was appointed General Counsel, upon the retirement of Mario Giovanoli, from 1 January 2006.

It was with deep regret that the Bank learned of the death of Antonino Occhiuto, Honorary Director General of the Bank of Italy, on 27 June 2005. Mr Occhiuto had served on the Board as an appointed Director between 1975 and 1980.

The Board noted with deep regret the death of Wim Duisenberg on 31 July 2005. Mr Duisenberg had served on the Board as a Director from 1982 to 1997. During this time, he had served two terms as President of the Bank and Chairman of the Board of Directors from 1988 to 1990 and from 1994 to 1997.

BIS member central banks[5]

Bank of Algeria

Central Bank of Argentina

Reserve Bank of Australia

Austrian National Bank

National Bank of Belgium

Central Bank of Bosnia and Herzegovina

Central Bank of Brazil

Bulgarian National Bank

Bank of Canada

Central Bank of Chile

People's Bank of China

Croatian National Bank

Czech National Bank

National Bank of Denmark

Bank of Estonia

European Central Bank

Bank of Finland

Bank of France

Deutsche Bundesbank (Germany)

Bank of Greece

Hong Kong Monetary Authority

Magyar Nemzeti Bank (Hungary)

Central Bank of Iceland

Reserve Bank of India

Bank Indonesia

Central Bank & Financial Services Authority of Ireland

Bank of Israel

Bank of Italy

Bank of Japan

Bank of Korea

Bank of Latvia

Bank of Lithuania

National Bank of the Republic of Macedonia

Central Bank of Malaysia

Bank of Mexico

Netherlands Bank

Reserve Bank of New Zealand

Central Bank of Norway

Bangko Sentral ng Pilipinas

National Bank of Poland

Bank of Portugal

National Bank of Romania

Central Bank of the Russian Federation

Saudi Arabian Monetary Agency

Monetary Authority of Singapore

National Bank of Slovakia

Bank of Slovenia

South African Reserve Bank

Bank of Spain

Sveriges Riksbank (Sweden)

Swiss National Bank

Bank of Thailand

Central Bank of the Republic of Turkey

Bank of England

Board of Governors of the Federal Reserve System

5 In accordance with Article 15 of its Statutes, the Bank's capital is held by central banks only. The legal status of the Yugoslav issue of the capital of the BIS is currently under review following the constitutional changes in February 2003 which transformed the Federal Republic of Yugoslavia into the State Union of Serbia and Montenegro, with two separate central banks.

Financial statements

as at 31 March 2006

The financial statements on pages 190–224 for the financial year ended 31 March 2006 were approved on 8 May 2006. They are presented in a form approved by the Board of Directors pursuant to Article 49 of the Bank's Statutes and are subject to approval by the shareholders at their Annual General Meeting on 26 June 2006.

Jean-Pierre Roth	Malcolm D Knight
Chairman	General Manager

Balance sheet

As at 31 March 2006

SDR millions	Notes	**2006**	2005
Assets			
Cash and sight accounts with banks	5	33.0	25.8
Gold and gold deposits	6	11,348.0	8,617.0
Treasury bills	7	47,311.9	31,307.4
Securities purchased under resale agreements	7	19,519.2	14,034.3
Time deposits and advances to banks	8	87,898.5	80,316.5
Government and other securities	7	44,436.4	39,779.6
Derivative financial instruments	9	1,956.0	2,188.0
Accounts receivable	10	7,444.7	4,028.6
Land, buildings and equipment	11	188.4	189.2
Total assets		**220,136.1**	180,486.4
Liabilities			
Currency deposits	12	185,991.5	150,618.8
Gold deposits	13	9,235.6	7,110.8
Securities sold under repurchase agreements	14	1,222.4	1,159.4
Derivative financial instruments	9	2,674.9	3,440.6
Accounts payable	15	9,251.3	7,752.2
Other liabilities	16	169.4	151.3
Total liabilities		**208,545.1**	170,233.1
Shareholders' equity			
Share capital	17	683.9	683.9
Statutory reserves	18	9,071.7	8,743.2
Profit and loss account		599.2	370.9
Less: shares held in treasury	20	(1.7)	(396.2)
Other equity accounts	21	1,237.9	851.5
Total equity		**11,591.0**	10,253.3
Total liabilities and equity		**220,136.1**	180,486.4

Profit and loss account

For the financial year ended 31 March 2006

SDR millions	Notes	**2006**	2005
Interest income	23	6,239.1	4,058.8
Interest expense	24	(5,569.1)	(3,384.1)
Net valuation movement	25	(74.1)	(183.1)
Net interest income		**595.9**	491.6
Net fee and commission income	26	2.7	1.3
Net foreign exchange loss	27	(25.2)	(34.5)
Total operating income		**573.4**	458.4
Operating expense	28	(146.9)	(145.0)
Operating profit		**426.5**	313.4
Net gain on sales of investment securities	29	58.2	7.0
Net gain on sales of gold investment assets	30	114.5	50.5
Net profit for the financial year		**599.2**	370.9

Basic and diluted earnings per share (in SDR per share)	31	**1,108.5**	762.1

Statement of cash flows

For the financial year ended 31 March 2006

SDR millions	Notes	**2006**	2005
Cash flow from / (used in) operating activities			
Operating profit		426.5	313.4
Non-cash flow items included in operating profit			
Depreciation of land, buildings and equipment	11	13.3	15.7
Net change in operating assets and liabilities			
Currency deposits		31,732.0	15,329.4
Currency banking assets		(30,719.4)	(16,371.2)
Gold deposit liabilities		2,124.8	(182.7)
Gold and gold deposit banking assets		(2,118.0)	322.6
Accounts receivable		0.3	1.3
Other liabilities / accounts payable		19.6	17.5
Net derivative financial instruments		(533.7)	234.0
Net cash flow from / (used in) operating activities		**945.4**	(320.0)
Cash flow from / (used in) investing activities			
Net change in currency investment assets	7B	(1,676.9)	207.2
Securities sold under repurchase agreements		63.0	(65.9)
Net change in gold investment assets	6B	187.9	110.7
Net purchase of land, buildings and equipment	11	(12.6)	(14.9)
Net cash flow from / (used in) investing activities		**(1,438.6)**	237.1
Cash flow from / (used in) financing activities			
Dividends paid		(114.4)	(104.0)
Redistribution of shares held in treasury	20	468.2	536.7
Shares repurchased in 2001 – payments to former shareholders	16	(1.5)	(10.6)
Net cash flow from / (used in) financing activities		**352.3**	422.1
Total net cash flow		**(140.9)**	339.2
Net effect of exchange rate changes on cash and cash equivalents		108.0	(10.1)
Net movement in cash and cash equivalents		(248.9)	349.3
Net increase / (decrease) in cash and cash equivalents		**(140.9)**	339.2
Cash and cash equivalents, beginning of year	32	3,005.5	2,666.3
Cash and cash equivalents, end of year	32	**2,864.6**	3,005.5

Statement of proposed profit allocation

For the financial year ended 31 March 2006

SDR millions	Notes	2006
Net profit for the financial year		**599.2**
Transfer to legal reserve fund	18	–
Proposed dividend:		
SDR 245 per share on 510,192 shares		(125.0)
On 35,933 redistributed treasury shares (pro rata as from the value date of the share subscription)	17	(7.4)
		(132.4)
Proposed transfers to reserves:		**466.8**
General reserve fund	18	(46.7)
Special dividend reserve fund	18	(6.0)
Free reserve fund	18	(414.1)
Balance after allocation to reserves		**–**

The proposed profit allocation is in accordance with Article 51 of the Bank's Statutes.

Movements in the Bank's statutory reserves

For the financial year ended 31 March 2006

						2006
SDR millions	Notes	Legal reserve fund	General reserve fund	Special dividend reserve fund	Free reserve fund	Total statutory reserves
Balance at 31 March 2005		**68.3**	**2,815.4**	**130.0**	**5,729.5**	**8,743.2**
Allocation of 2004/05 profit	18	–	25.7	6.0	224.8	256.5
Redistribution of shares held in treasury	20	–	72.0	–	–	72.0
Balance at 31 March 2006 per balance sheet before proposed profit allocation		**68.3**	**2,913.1**	**136.0**	**5,954.3**	**9,071.7**
Proposed transfers to reserves	18	–	46.7	6.0	414.1	466.8
Balance at 31 March 2006 after proposed profit allocation		**68.3**	**2,959.8**	**142.0**	**6,368.4**	**9,538.5**

Movements in the Bank's equity

For the financial year ended 31 March 2006

SDR millions	Notes	Share capital	Statutory reserves	Profit and loss	Shares held in treasury	Other equity accounts	Total equity
Equity at 31 March 2004		**683.9**	**8,230.8**	**536.1**	**(852.6)**	**1,011.8**	**9,610.0**
Income:							
Net profit for 2004/05		–	–	370.9	–	–	370.9
Net valuation movement on gold investment assets	21B	–	–	–	–	(74.0)	(74.0)
Net valuation movement on investment securities	21A	–	–	–	–	(86.3)	(86.3)
Total recognised income		**–**	**–**	**370.9**	**–**	**(160.3)**	**210.6**
Payment of 2003/04 dividend		–	–	(104.0)	–	–	(104.0)
Allocation of 2003/04 profit		–	432.1	(432.1)	–	–	–
Redistribution of shares held in treasury	20	–	80.3	–	456.4	–	536.7
Equity at 31 March 2005		**683.9**	**8,743.2**	**370.9**	**(396.2)**	**851.5**	**10,253.3**
Income:							
Net profit for 2005/06		–	–	599.2	–	–	599.2
Net valuation movement on gold investment assets	21B	–	–	–	–	582.9	582.9
Net valuation movement on investment securities	21A	–	–	–	–	(196.5)	(196.5)
Total recognised income		**–**	**–**	**599.2**	**–**	**386.4**	**985.6**
Payment of 2004/05 dividend		–	–	(114.4)	–	–	(114.4)
Allocation of 2004/05 profit		–	256.5	(256.5)	–	–	–
Redistribution of shares held in treasury	20	–	72.0	–	396.2	–	468.2
Reclassification of loan to a consortium of central banks	20	–	–	–	(1.7)	–	(1.7)
Equity at 31 March 2006 per balance sheet before proposed profit allocation		**683.9**	**9,071.7**	**599.2**	**(1.7)**	**1,237.9**	**11,591.0**
Proposed dividend		–	–	(132.4)	–	–	(132.4)
Proposed transfers to reserves		–	466.8	(466.8)	–	–	–
Equity at 31 March 2006 after proposed profit allocation		**683.9**	**9,538.5**	**–**	**(1.7)**	**1,237.9**	**11,458.6**

At 31 March 2006 statutory reserves included share premiums of SDR 811.7 million (2005: SDR 811.7 million).

Notes to the financial statements

1. Introduction

The Bank for International Settlements (BIS, "the Bank") is an international financial institution which was established pursuant to the Hague Agreements of 20 January 1930, the Bank's Constituent Charter and its Statutes. The headquarters of the Bank are at Centralbahnplatz 2, 4002 Basel, Switzerland. The Bank maintains representative offices in Hong Kong, Special Administrative Region of the People's Republic of China (for Asia and the Pacific) and in Mexico City, Mexico (for the Americas).

The objectives of the BIS, as laid down in Article 3 of its Statutes, are to promote cooperation among central banks, to provide additional facilities for international financial operations and to act as trustee or agent for international financial settlements. Fifty-five central banks are currently members of the Bank. Rights of representation and voting at General Meetings are exercised in proportion to the number of BIS shares issued in the respective countries. The Board of Directors of the Bank is composed of the Governors of and appointed Directors from the Bank's founder central banks, being the central banks of Belgium, France, Germany, Italy, the United Kingdom and the United States of America, as well as the Governors of the central banks of Canada, Japan, the Netherlands, Sweden and Switzerland.

These financial statements incorporate the balance sheet and profit and loss account, as required by Article 49 of the Bank's Statutes.

2. Significant accounting policies

The accounting policies set out below have been applied to both of the financial years presented unless otherwise stated.

A. Scope of the financial statements

These financial statements contain all assets and liabilities that are controlled by the Bank and in respect of which the economic benefits as well as the rights and obligations lie predominantly with the Bank.

Assets and liabilities in the name of but not controlled by the Bank are not included in these financial statements. Information on off-balance sheet assets and liabilities is disclosed in Note 35.

B. Designation of financial instruments

Upon initial recognition each financial instrument is allocated to one of the following categories, depending on the nature of the financial instrument and the purpose for which it was entered into:

- Loans and receivables
- At fair value through profit and loss
- Available for sale

The designation of the financial instrument determines the accounting that is applied, as described in the accounting policies below.

Where the financial instrument is designated at fair value through profit and loss, the Bank does not subsequently change this designation.

C. Functional and presentation currency

The functional and presentation currency of the Bank is the Special Drawing Right (SDR) as defined by the International Monetary Fund (IMF).

The SDR is calculated from a basket of major trading currencies according to Rule O–1 as adopted by the Executive Board of the IMF on 30 December 2005 and effective 1 January 2006. As currently calculated, one SDR is equivalent to the sum of USD 0.632, EUR 0.410, JPY 18.4 and GBP 0.0903. Prior to 1 January 2006, the SDR was calculated as equivalent to the sum of USD 0.577, EUR 0.426, JPY 21 and GBP 0.0984. The change in composition of the SDR basket was such that the values of the SDR under the old and new baskets were equivalent at 31 December 2005 and no significant gains or losses resulted from the change in the weights of the currencies. The composition of this currency basket is subject to review every five years by the IMF, the next review being undertaken in December 2010.

All figures in these financial statements are presented in SDR millions unless otherwise stated.

D. Currency translation

Monetary assets and liabilities are translated into SDR at the exchange rates ruling at the balance sheet date. Other assets and liabilities are recorded in SDR at the exchange rates ruling at the date of the transaction. Profits and losses are translated into SDR at an average rate. Exchange differences arising from the retranslation of monetary assets and liabilities and from the settlement of transactions are included as net foreign exchange gains or losses in the profit and loss account.

E. Very short-term monetary assets and liabilities

Very short-term monetary assets comprise cash and sight accounts with banks, and call and notice accounts (which are included under the balance sheet heading "Time deposits and advances to banks"). Very short-term liabilities comprise sight and notice deposits (which are included under the balance sheet heading "Currency deposits"). These financial instruments typically have notice periods of three days or less. They are designated as loans and receivables.

They are included in the balance sheet on a settlement date basis at their principal value plus accrued interest. Interest is included in interest income (for assets) or interest expense (for liabilities) on an accruals basis.

F. Gold and gold deposits

Gold comprises gold bars held in sight accounts. Gold deposit assets comprise fixed-term gold loans to commercial banks. Gold deposit liabilities comprise sight and fixed-term deposits of gold from central banks. They are designated as loans and receivables.

These financial instruments are included in the balance sheet at their weight in gold (translated at the gold market price and USD exchange rate into SDR) plus accrued interest.

Gold deposit assets and liabilities are included on a trade date basis. Purchases and sales of gold are accounted for on a settlement date basis. Forward purchases or sales of gold are treated as derivatives prior to the settlement date.

Interest on gold deposits is included in interest income (for assets) or interest expense (for liabilities) on an accruals basis. The treatment of the realised and unrealised gains or losses on revaluation depends on the designation of the gold deposits as described below:

1. Gold deposit liabilities and related gold banking assets

The Bank operates a banking business in gold on behalf of central bank customers in which it takes limited gold price risk. These financial instruments are designated as loans and receivables. Gains or losses on these transactions in gold are included under the profit and loss account heading "Net foreign exchange gain or loss" as net transaction gains or losses.

Gains or losses on the retranslation of the net position in gold in the banking business are included under the profit and loss account heading "Net foreign exchange gain or loss" as net translation gains or losses.

2. Gold investment assets

The Bank's own holdings of gold are designated as available for sale assets. Unrealised gains or losses on the Bank's gold investment assets over their cost are taken to the gold revaluation account in equity, which is reported under the balance sheet heading "Other equity accounts".

For gold investment assets held on 31 March 2003 (when the Bank changed its functional and presentation currency from the gold franc to the SDR) the deemed cost is approximately SDR 151 per ounce, based on the value of USD 208 that was applied from 1979 to 2003 following a decision by the Bank's Board of Directors, translated at the 31 March 2003 exchange rate.

Realised gains or losses on disposal of gold investment assets are included in the profit and loss account as "Net gain on sales of gold investment assets".

G. Currency investment assets

Currency investment asset comprise securities purchased under resale agreements and government and other securities. They are held for the long term, but not necessarily to maturity. They are designated as available for sale assets.

They are initially included in the balance sheet on a trade date basis at cost. The subsequent accrual of interest and amortisation of premiums paid and discounts received are included in "Interest income".

After trade date, currency investment assets are revalued to fair value, with unrealised gains or losses included in the securities revaluation account, which is reported under the balance sheet heading "Other equity accounts". Realised profits on disposal are included under the profit and loss heading "Net gain on sales of investment securities".

H. Securities sold under repurchase agreements

Where these liabilities are associated with the management of currency banking assets, they are designated as financial instruments held at fair value through profit and loss. Where these liabilities are associated with currency investment assets they are designated as loans and receivables.

They are initially included in the balance sheet on a trade date basis at cost. The subsequent accrual of interest is included in "Interest expense".

After trade date, those liabilities that are designated as at fair value through profit and loss are revalued to fair value, with unrealised gains or losses included under the profit and loss account heading "Net valuation movement".

I. Derivatives

Derivatives are used either to manage the Bank's market risk or for trading purposes. They are designated as financial instruments held at fair value through profit and loss.

They are initially included in the balance sheet on a trade date basis at cost. The subsequent accrual of interest and amortisation of premiums paid and discounts received are included in "Interest income".

After trade date, derivatives are revalued to fair value, with all realised and unrealised movements in value included under the profit and loss account heading "Net valuation movement".

Derivatives are included as either assets or liabilities, depending on whether the contract has a positive or a negative fair value for the Bank.

J. Currency deposit liabilities and related banking assets

These financial instruments constitute the majority of the Bank's balance sheet and include treasury bills, securities purchased under resale agreements, time deposits and advances to banks, government and other securities and currency deposits.

The accounting treatment for very short-term currency deposit liabilities is detailed in section E above.

The Bank acts as a market-maker in certain of its currency deposit liabilities. As a result of this activity the Bank incurs realised profits and losses on these liabilities.

In accordance with the Bank's risk management policies the market risk inherent in this activity is managed on an overall fair value basis, combining all the relevant assets, liabilities and derivatives in its currency banking portfolios. The realised and unrealised profits or losses on currency deposit liabilities are thus largely offset by realised and unrealised losses or profits on currency banking assets, derivatives or other currency deposit liabilities.

To reduce the accounting inconsistency that would otherwise arise from recognising realised and unrealised gains and losses on different bases, the Bank designates all of the relevant assets and liabilities in its currency banking portfolios as held at fair value through profit and loss.

All the relevant financial instruments are initially included in the balance sheet on a trade date basis at cost. The subsequent accrual of interest and amortisation of premiums paid and discounts received are included in "Interest expense" (for currency deposit liabilities) or in "Interest income" (for related banking assets).

After trade date, the financial instruments are revalued to fair value, with all realised and unrealised movements in value included under the profit and loss account heading "Net valuation movement".

K. Valuation policy

The Bank includes most of its financial instruments in its balance sheet at fair value, and includes most changes in fair value in profit and loss. The fair value of a financial instrument is defined as the amount at which the instrument could be exchanged between knowledgeable willing parties in an arm's length current transaction. Key judgments affecting this accounting policy relate to how the Bank determines fair value for financial instruments.

To derive fair value the Bank uses reliable quoted market prices from active markets. Where no active market exists, or where quoted market prices are not otherwise available, the Bank determines fair values based on financial models using a discounted cash flow analysis. A discounted cash flow analysis is dependent on estimates of future cash flows, interest rates, exchange rates and prepayment speeds, and upon credit, liquidity and volatility factors.

Although a significant degree of judgment is, in some cases, required in establishing fair values, the Bank believes the fair values recorded in the balance sheet and the changes in fair values recorded in the profit and loss account are appropriate and reflect the underlying economic situation.

L. Accounts receivable and accounts payable

Accounts receivable and accounts payable are principally very short-term amounts relating to the settlement of financial transactions. They are included in the balance sheet at cost.

M. Land, buildings and equipment

The cost of the Bank's buildings and equipment is capitalised and depreciated on a straight line basis over the estimated useful lives of the assets concerned, as follows:

Buildings – 50 years

Building installations and machinery – 15 years

Information technology equipment – up to 4 years

Other equipment – 4 to 10 years

The Bank's land is not depreciated. The Bank undertakes an annual review of impairment of land, buildings and equipment. Where the carrying amount of an asset is greater than its estimated recoverable amount, it is written down to that amount.

N. Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of events arising before the balance sheet date and it is probable that economic resources will be required to settle the obligation, provided that a reliable estimate can be made of the amount of the obligation. Best estimates and assumptions are used when determining the amount to be recognised as a provision.

O. Post-employment benefit obligations

The Bank operates three post-employment benefit arrangements for staff pensions, directors' pensions and health and accident insurance for current and former staff members. An independent actuarial valuation is performed annually for each arrangement.

Staff pensions

The Bank provides a final salary defined benefit pension arrangement for its staff, based on a fund without separate legal personality, out of which benefits are paid. The fund assets are administered by the Bank for the sole benefit of current and former members of staff who participate in the arrangement. The Bank remains ultimately liable for all benefits due under the arrangement.

The liability in respect of the staff pension fund is based on the present value of the defined benefit obligation at the balance sheet date, less the fair value of the fund assets at the balance sheet date, together with adjustments for unrecognised actuarial gains and losses and past service costs. The defined benefit obligation is calculated using the projected unit credit method. The present value of the defined benefit obligation is determined from the estimated future cash outflows. The rate used to discount the cash flows is determined by the Bank based on the market yield of highly rated corporate debt securities in Swiss francs which have terms to maturity approximating the terms of the related liability.

The amount charged to the profit and loss account represents the sum of the current service cost of the benefits accruing for the year under the scheme, and interest at the discount rate on the defined benefit obligation. In addition, actuarial gains and losses arising from experience adjustments (where the actual outcome is different from the actuarial assumptions previously made), changes in actuarial assumptions and amendments to the pension fund regulations are charged to the profit and loss account over the service period of staff concerned in accordance with the "Corridor accounting" methodology described below. The resulting liabilities are included under the heading "Other liabilities" in the balance sheet.

Directors' pensions

The Bank provides an unfunded defined benefit arrangement for directors' pensions. The liability, defined benefit obligation and amount charged to the profit and loss account in respect of the directors' pension arrangement are calculated on a similar basis to that used for the staff pension fund.

Post-employment health and accident benefits

The Bank provides an unfunded post-employment health and accident benefit arrangement for its staff. The liability, benefit obligation and amount charged to the profit and loss account in respect of the health and accident benefit arrangement are calculated on a similar basis to that used for the staff pension fund.

Corridor accounting

Actuarial gains or losses arise from experience adjustments (where the actual outcome is different from the actuarial assumptions previously made), changes in actuarial assumptions and amendments to the pension fund regulations. Where the cumulative unrecognised actuarial gains or losses exceed the higher of the benefit obligation or any assets used to fund the obligation by more than a corridor of 10%, the resulting excess outside the corridor is amortised over the expected remaining service period of the staff concerned.

P. Cash flow statement

The Bank's cash flow statement is prepared using an indirect method. It is based on the movements in the Bank's balance sheet, adjusted for changes in financial transactions awaiting settlement.

Cash and cash equivalents consist of cash and sight accounts with banks, and call and notice accounts, which are very short-term financial assets that typically have notice periods of three days or less.

3. Use of estimates

The preparation of the financial statements requires the Bank's Management to make some estimates in arriving at the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the financial year. To arrive at these estimates the Management uses available information, exercises judgment and makes assumptions.

Judgment is exercised when selecting accounting policies for the Bank and also when applying the accounting policies. The judgments relating to the designation and valuation of financial instruments are key to understanding these financial statements.

Assumptions include forward-looking estimates, for example related to the valuation of assets and liabilities, the assessment of post-employment benefit obligations and the assessment of provisions and contingent liabilities.

Subsequent actual results could differ materially from those estimates.

4. Capital and risk management

A. The risks that the Bank faces

The Bank is exposed to the following categories of risk:

Credit risk. The risk of a financial loss arising from a counterparty's failure to service its debt in a timely manner. This is the largest risk that the Bank faces.

Market risk. The risk of a decline in the total value of the Bank's assets and liabilities due to adverse changes in such market variables as interest rates, exchange rates and gold prices.

Liquidity risk. The risk of being unable to meet its obligations to pay as they fall due without incurring unacceptable losses.

Operational risk. The risk of financial losses, damage to the Bank's reputation, or both, caused by people, failed or inadequate processes or systems, or external events.

B. How the Bank manages these risks

Organisation structure

The Bank is operated to serve the central banking community whilst earning an adequate return to maintain its capital strength.

The Bank manages risk through a framework including an independent risk control function and regular reporting of risk positions to appropriate Management committees. The Bank's risk methodologies and risk policies are documented in a detailed risk manual, which is reviewed on a regular basis. The Bank's credit limits are documented in a counterparty manual. All changes to credit limits require Management approval.

The finance function and legal service augment the risk control function. The role of the finance function is to produce the Bank's financial statements and to control its expenditure through setting and monitoring the annual budget. The legal service provides legal advice and support covering a wide range of issues relating to the Bank's activities.

The purpose of the Bank's compliance function is to provide reasonable assurance that the activities of the Bank and its staff conform with applicable laws and regulations, the BIS Statutes, the Bank's Code of Conduct and other internal rules, policies and relevant standards of sound practice. The compliance function identifies and assesses compliance risks and guides and educates staff on compliance issues. It also performs a monitoring, reporting and, in cooperation with the legal service, an advisory role.

The internal audit function reviews internal control procedures and reports on how they comply with internal standards and industry best practices. The scope of internal audit work includes the review of risk management procedures, internal control systems, information systems and governance processes. Internal audit is directly responsible to the General Manager and the Deputy General Manager.

The Deputy General Manager is responsible for the Bank's risk control and compliance functions.

The head of compliance and head of internal audit also report regularly to the Audit Committee of the Board of Directors.

Asset and liability structure

Assets and liabilities are organised into two books:

1. A banking book comprising currency and gold deposit liabilities and related banking assets and derivatives.

In this book the Bank takes limited interest rate, gold price and foreign currency risk.

2. An investment book comprising assets, liabilities and derivatives relating principally to the investment of the Bank's equity.

The Bank holds most of its equity in financial instruments denominated in the constituent currencies of the SDR, which are managed using a fixed duration benchmark of bonds. The remainder of the Bank's equity is held in gold.

C. Risk methodologies

The Bank uses a comprehensive range of quantitative methodologies for valuing financial instruments and for measuring risk to the Bank's net profit and its equity. The Bank reassesses its quantitative methodologies in the light of its changing risk environment and evolving best practice.

Economic capital is a key quantitative risk methodology used by the Bank. Economic capital is a measure designed to estimate the amount of equity needed to absorb the potential losses arising from exposures on any given date, to a statistical level of confidence determined by the Bank's aim to remain of the highest creditworthiness. Many of the Bank's internal limits and reports are expressed in terms of economic capital. The Bank calculates economic capital covering credit risk, market risk and operational risk.

To calculate economic capital for credit risk the Bank uses an internal model for credit portfolio value-at-risk that is based on the Bank's assessment of:

- The probability of default of individual counterparties;
- The correlations of losses associated with individual counterparties; and
- The likely loss that the Bank would incur as a result of the default.

The market risk economic capital measure is derived from the Bank's value-at-risk (VaR) methodology. This is discussed in more detail in section F below.

The Bank's operational risk economic capital measure is based on a model that incorporates the Bank's experience of operational losses and external loss data.

In computing its credit, market and operational risk economic capital measures the Bank uses as key assumptions a one-year time horizon and a 99.995% level of confidence.

D. Capital adequacy

The Bank maintains a very strong capital position, which is measured using its economic capital model and the framework proposed by the Basel Capital Accord of July 1988 (the Basel Accord). The table below shows the Bank's capital as at 31 March 2006:

As at 31 March

SDR millions	**2006**	2005
Share capital	683.9	683.9
Statutory reserves	9,071.7	8,743.2
Less: shares held in treasury	(1.7)	(396.2)
Tier 1 capital	**9,753.9**	9,030.9
Profit and loss account	599.2	370.9
Other equity accounts	1,237.9	851.5
Total capital	**11,591.0**	10,253.3

The Basel Accord ratios measure capital adequacy by comparing the Bank's eligible capital with its risk-weighted assets. The risk-weighted assets are derived by applying a series of risk weightings to the Bank's assets and derivatives, based on the Basel Accord. The Bank's capital ratios are high due to the proportion of sovereign debt (which is zero risk-weighted) within the Bank's assets. The Bank's Tier 1 ratio was 32.4% as at 31 March 2006 (2005: 35.8%).

E. Credit risk

Credit risk includes:

Default risk – the risk that a counterparty will not fulfil its obligations in accordance with the agreed terms of a transaction. Default risk arises on financial assets and derivatives, as well as committed facilities that the Bank provides for central banks and international organisations.

Settlement risk – the risk of failure of the settlement or clearing of financial transactions where the exchange of cash, securities or other assets is not simultaneous.

Transfer risk – the risk that a counterparty is unable to meet its foreign currency obligations due to restricted access to foreign currency.

The Bank manages its exposure to credit risk by placing limits on the amount of risk accepted in relation to one borrower or a group of borrowers. Such risks are monitored on a regular basis and are subject to at least an annual review and will be adjusted as deemed appropriate. The main criterion for these reviews is the ability of borrowers and potential borrowers to meet interest and capital repayment obligations. Limits on the level of credit risk are approved by the Bank's Management within a framework set by the Board of Directors. Actual exposures are monitored daily against limits.

The Bank also obtains collateral, in addition to reverse repurchase agreements, to mitigate credit risk on derivative financial instruments, and has established bilateral setoff agreements with certain of its counterparties.

1. Default risk

The Bank controls its default risk on both a counterparty and a portfolio level. Credit exposures are restricted using a series of credit limits covering individual counterparties and countries of risk. The Bank conducts its own detailed independent credit analysis resulting in the assignment of internal credit grades. Based on this analysis the Bank sets its credit limits.

Default risk on the Bank's holdings of securities is reduced by the highly liquid nature of most of the assets. Securities are sold when the Bank's Management considers that a counterparty has an unacceptable risk of default.

Default risk on over-the-counter (OTC) derivatives is mitigated using collateral management agreements. As at 31 March 2005 the Bank held as collateral on OTC derivatives SDR 93.6 million nominal of G10 sovereign securities. The Bank held no collateral on OTC derivatives at 31 March 2006.

The Bank's credit policies ensure that the vast majority of its assets are invested with G10 sovereigns or with financial institutions rated A or above. Because of the limited number of potential investments, the Bank has significant individual counterparty concentrations within these risk sectors.

The following tables show credit exposure by sector and credit rating:

As at 31 March

Sector of risk *Percentages*	**2006**	2005
Sovereign	34.1	32.5
Financial institution	63.1	61.7
Other	2.8	5.8
	100.0	100.0

As at 31 March

BIS internal credit grade (expressed as equivalent long-term rating) *Percentages*	**2006**	2005
AAA	26.5	26.3
AA	54.7	57.0
A	18.5	16.1
BBB+ and below (including unrated risks)	0.3	0.6
	100.0	100.0

2. Settlement risk

The Bank minimises settlement risk by:

- Using established clearing centres;
- Where possible settling transactions only once both parties have fulfilled their obligations (the delivery versus payment settlement mechanism);
- Where possible requiring net settlement of payments on derivative financial instruments;
- Using cash correspondent banks with the ability to stop payments at short notice;
- In respect of foreign exchange transactions, ensuring where possible that these take place subject to setoff arrangements that would apply should a counterparty fail to deliver the counter-currency to such a transaction; and
- Calculating and limiting the settlement risk on a counterparty basis.

3. Transfer risk

The Bank calculates and sets limits for transfer risk on a per country basis.

F. Market risk

The main components of the Bank's market risk are gold price risk, currency risk and interest rate risk. The Bank incurs market risk primarily through the assets relating to the management of its equity. The Bank measures market risk using the value-at-risk (VaR) methodology, and by computing sensitivities to certain market risk factors. VaR expresses the statistical estimate of the maximum potential loss on the current portfolio assuming a specified time horizon and measured to a specified level of confidence.

Market risk economic capital is measured and managed on an aggregated market risk basis. The Bank's Management limits the Bank's market risk economic capital usage within a framework set by the Board of Directors.

All VaR models, while forward-looking, are based on past events and dependent on the quality of available market data. VaR limits are supplemented with a framework of other limits and reporting, including specific stress tests and detailed monitoring of the largest market risk positions.

1. Gold price risk

Gold price risk is the potential impact on the fair value of assets and liabilities from changes in the SDR price of gold. The Bank is exposed to gold price risk principally through its holdings of gold investment assets, which comprise 165 tonnes (2005: 180 tonnes). This is held in custody or placed on deposit with commercial banks. At 31 March 2006 approximately 19% of its equity comprised gold holdings (31 March 2005: 16%). The Bank can also have small exposures to gold price risk through its banking activities with central and commercial banks. Gold price risk is measured within the Bank's aggregate market risk economic capital framework.

2. Currency risk

Currency risk is the potential impact on the fair value of assets and liabilities from changes in exchange rates. The Bank is exposed to currency risk principally through the assets relating to the management of its equity. The Bank is also exposed to currency risk through managing its customer deposits and through acting as an intermediary in foreign exchange transactions between central and commercial banks. The Bank reduces its currency exposures by matching the assets relating to the management of its equity to the constituent currencies of the SDR on a regular basis, and by allowing only small currency exposures relating to customer deposits and foreign exchange transaction intermediation.

The following table shows the Bank's currency positions after adjusting for its holdings of gold investment assets:

Net assets as at 31 March

SDR millions	**2006**	2005
Swiss franc	(140.6)	(137.0)
US dollar	26.7	21.3
Euro	(20.0)	4.3
Japanese yen	21.3	36.7
Pound sterling	17.1	12.7
Swedish krona	56.4	58.1
Australian dollar	34.7	0.7
Other currencies	4.4	3.2

The Swiss franc position above is attributable principally to the Bank's post-employment benefit obligations (see note 22).

3. Interest rate risk

Interest rate risk is the potential impact on the fair value of assets and liabilities from changes in interest rates. The Bank is exposed to interest rate risk principally through the interest-bearing assets relating to the management of its equity. These assets are managed using a fixed duration benchmark of bonds. The Bank is also exposed to limited interest rate risk through its activities in accepting and reinvesting customer deposits.

The Bank closely monitors interest rate risk including the sensitivity of fair values to movements in interest rates. Market risk is restricted using economic capital, VaR and stress test-based limits.

The tables below show the impact on the Bank's equity of a 1% upward shift in the relevant yield curve:

As at 31 March 2006

SDR millions	Up to 6 months	6 to 12 months	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	Over 5 years
Euro	(3.7)	(4.7)	(5.9)	(9.2)	(22.3)	(19.7)	(70.3)
Japanese yen	0.4	0.1	(5.4)	(5.0)	(7.1)	(6.5)	(14.1)
Pound sterling	–	(5.3)	(3.9)	(4.9)	(6.4)	(9.5)	(12.3)
Swiss franc	(0.5)	(0.9)	(1.3)	–	(0.4)	(0.1)	–
US dollar	(4.7)	(23.9)	(32.3)	(18.4)	(17.8)	(26.2)	(78.3)
Other currencies	(1.8)	7.8	(15.1)	(22.4)	(0.3)	(6.6)	(0.2)
Total	**(10.3)**	**(26.9)**	**(63.9)**	**(59.9)**	**(54.3)**	**(68.6)**	**(175.2)**

As at 31 March 2005

SDR millions	Up to 6 months	6 to 12 months	1 to 2 years	2 to 3 years	3 to 4 years	4 to 5 years	Over 5 years
Euro	(4.6)	(4.5)	(11.6)	(11.1)	(11.2)	(17.8)	(67.8)
Japanese yen	2.0	(1.0)	(2.5)	(2.0)	(2.6)	(3.0)	(8.1)
Pound sterling	(0.8)	1.6	(9.8)	(6.1)	(5.4)	(9.9)	(12.1)
Swiss franc	(0.3)	0.3	0.1	–	–	–	–
US dollar	16.2	21.0	(46.4)	(7.4)	(9.0)	(17.4)	(56.6)
Other currencies	(0.3)	0.1	(0.1)	–	–	–	–
Total	12.2	17.5	(70.3)	(26.6)	(28.2)	(48.1)	(144.6)

G. Liquidity risk

Net movements in the currency and gold deposits from central banks, international organisations and other public institutions are the key determinants of the size of the Bank's balance sheet. The Bank has undertaken to repurchase at fair value certain of its currency deposit instruments at one or two business days' notice. The Bank is managed to preserve a high degree of liquidity to ensure that it is able to meet the requirements of its customers at all times.

The Bank has developed a liquidity management framework based on a statistical model using prudent assumptions with regard to cash inflows and the liquidity of liabilities. Within this framework, the Board of Directors has set a limit for the Bank's liquidity ratio which requires liquid assets to be equal to at least 100% of the potential liquidity requirement faced by the Bank. In addition, liquidity stress tests are performed which assume extreme withdrawal scenarios considerably beyond the estimated potential liquidity requirement. These stress tests define additional liquidity requirements which must also be met by holdings of liquid assets. The Bank's liquidity has consistently been materially above its minimum liquidity ratio limit.

The following tables (including derivatives on a net basis) show assets and liabilities at carrying amounts based on the remaining period at the balance sheet date to the contractual maturity date:

As at 31 March 2006

SDR millions	Up to 1 month	1 to 3 months	3 to 6 months	6 to 9 months	9 to 12 months	1 to 5 years	Over 5 years	Maturity undefined	Total
Assets									
Cash and sight accounts with banks	33.0	–	–	–	–	–	–	–	33.0
Gold and gold deposits	7,312.1	329.4	608.0	268.0	156.0	2,569.8	104.7	–	11,348.0
Treasury bills	14,215.7	22,411.8	7,614.5	1,801.6	1,268.3	–	–	–	47,311.9
Securities purchased under resale agreements	19,474.6	44.6	–	–	–	–	–	–	19,519.2
Time deposits and advances to banks	38,682.6	16,856.1	13,981.8	9,046.6	9,264.1	67.3	–	–	87,898.5
Government and other securities	3,535.1	7,919.3	1,771.7	2,203.0	3,938.7	17,327.6	7,741.0	–	44,436.4
Accounts receivable	7,441.1	–	–	–	–	3.6	–	–	7,444.7
Land, buildings and equipment	–	–	–	–	–	–	–	188.4	188.4
Total	**90,694.2**	**47,561.2**	**23,976.0**	**13,319.2**	**14,627.1**	**19,968.3**	**7,845.7**	**188.4**	**218,180.1**
Liabilities									
Currency deposits									
Deposit instruments repayable at 1–2 days' notice	(12,646.4)	(15,448.5)	(17,430.3)	(15,872.5)	(8,429.0)	(34,217.9)	(3,970.7)	–	(108,015.3)
Other currency deposits	(50,941.0)	(5,048.0)	(6,618.4)	(7,604.0)	(7,601.4)	(163.4)	–	–	(77,976.2)
Gold deposits	(7,420.9)	(198.7)	(568.1)	(160.5)	(39.3)	(743.5)	(104.6)	–	(9,235.6)
Securities sold under repurchase agreements	(1,177.6)	(44.8)	–	–	–	–	–	–	(1,222.4)
Accounts payable	(9,251.3)	–	–	–	–	–	–	–	(9,251.3)
Other liabilities	(27.7)	–	–	–	–	–	–	(141.7)	(169.4)
Total	**(81,464.9)**	**(20,740.0)**	**(24,616.8)**	**(23,637.0)**	**(16,069.7)**	**(35,124.8)**	**(4,075.3)**	**(141.7)**	**(205,870.2)**
Net derivative financial instruments	195.8	129.5	(67.4)	(197.3)	(206.2)	(616.5)	43.2	–	(718.9)
Maturity gap	**9,425.1**	**26,950.7**	**(708.2)**	**(10,515.1)**	**(1,648.8)**	**(15,773.0)**	**3,813.6**	**46.7**	**11,591.0**

As at 31 March 2005

SDR millions	Up to 1 month	1 to 3 months	3 to 6 months	6 to 9 months	9 to 12 months	1 to 5 years	Over 5 years	Maturity undefined	Total
Assets									
Cash and sight accounts with banks	25.8	–	–	–	–	–	–	–	25.8
Gold and gold deposits	5,305.2	188.3	514.2	440.9	531.6	1,564.2	72.6	–	8,617.0
Treasury bills	5,908.1	12,716.2	6,718.6	3,044.3	2,920.2	–	–	–	31,307.4
Securities purchased under resale agreements	14,034.3	–	–	–	–	–	–	–	14,034.3
Time deposits and advances to banks	31,823.2	18,716.8	13,981.0	9,830.4	5,926.9	5.1	33.1	–	80,316.5
Government and other securities	3,454.0	4,086.4	3,014.8	2,795.1	5,110.3	16,167.4	5,151.6	–	39,779.6
Accounts receivable	4,021.5	–	–	–	–	3.5	–	3.6	4,028.6
Land, buildings and equipment	–	–	–	–	–	–	–	189.2	189.2
Total	64,572.1	35,707.7	24,228.6	16,110.7	14,489.0	17,740.2	5,257.3	192.8	178,298.4
Liabilities									
Currency deposits									
Deposit instruments repayable at 1–2 days' notice	(8,204.1)	(14,081.1)	(14,153.1)	(16,175.8)	(10,937.5)	(30,176.3)	(2,678.8)	–	(96,406.7)
Other currency deposits	(33,081.0)	(6,591.3)	(7,088.4)	(3,439.2)	(4,010.9)	(1.3)	–	–	(54,212.1)
Gold deposits	(5,423.1)	(133.7)	(487.5)	(331.2)	(287.7)	(375.0)	(72.6)	–	(7,110.8)
Securities sold under repurchase agreements	(1,159.4)	–	–	–	–	–	–	–	(1,159.4)
Accounts payable	(7,752.2)	–	–	–	–	–	–	–	(7,752.2)
Other liabilities	(17.3)	–	–	–	–	–	–	(134.0)	(151.3)
Total	(55,637.1)	(20,806.1)	(21,729.0)	(19,946.2)	(15,236.1)	(30,552.6)	(2,751.4)	(134.0)	(166,792.5)
Net derivative financial instruments	67.3	172.8	(152.1)	(43.6)	(236.8)	(823.8)	(236.4)	–	(1,252.6)
Maturity gap	9,002.3	15,074.4	2,347.5	(3,879.1)	(983.9)	(13,636.2)	2,269.5	58.8	10,253.3

H. Operational risk

Operational risk is defined by the Bank as the risk of financial loss, or damage to the Bank's reputation, or both, resulting from one or more of the following:

- Human error or fraud (eg insufficient personnel, lack of requisite knowledge, inadequate training, inadequate supervision, loss of key personnel, inadequate succession planning or lack of integrity or ethical standards);
- Failed or inadequate processes (eg an internal policy or process is inadequate, poorly designed or unsuitable, or is not properly documented, understood, implemented, followed or enforced);
- Failed or inadequate systems (eg hardware, software applications, operating systems or infrastructure necessary to support the activities of the Bank are poorly designed, unsuitable, inadequate, unavailable, fail, or do not operate as intended); and
- External events (ie the occurrence of an event having an adverse impact on the Bank but outside its control).

The Bank manages operational risk through internal controls, including policies, procedures, practices and organisational structures, designed to reduce the likelihood of an operational risk event occurring or that mitigate the adverse consequences of such an event if it does occur. The Bank allocates economic capital for operational risk on the basis of a statistical model that incorporates the Bank's experience of operational losses as well as external loss data.

The Bank is currently working on identifying and assessing operational risks and evaluating the effectiveness of existing controls through a Bank-wide Control Self-Assessment (CSA) programme. The Bank-wide rollout is expected to be completed by end-2006. A feasibility study has been carried out to assess possible ways to integrate CSA results and operational risk quantification. The BIS has further enhanced its control framework in recent years, strengthening its risk control, internal audit and compliance functions, and is currently working on a draft operational risk management framework.

5. Cash and sight accounts with banks

Cash and sight accounts with banks consist of cash balances with central and commercial banks that are available to the Bank on demand.

6. Gold and gold deposits

A. Total gold holdings

The composition of the Bank's total gold holdings was as follows:

As at 31 March

SDR millions	**2006**	2005
Gold bars held at central banks	7,132.0	5,170.2
Total gold time deposits	4,216.0	3,446.8
Total gold and gold deposit assets	**11,348.0**	8,617.0
Comprising:		
Gold investment assets	2,259.5	1,646.5
Gold and gold deposit banking assets	9,088.5	6,970.5

B. Gold investment assets

The Bank's gold investment assets are included in the balance sheet at their weight in gold (translated at the gold market price and USD exchange rate into SDR) plus accrued interest. The excess of this value over the deemed cost value is included in the gold revaluation account (reported under the balance sheet heading "Other equity accounts"), and realised gains or losses on the disposal of gold investment assets are recognised in the profit and loss account.

Note 21B provides further analysis of the gold revaluation account. Note 30 provides further analysis of the net gain on sales of gold investment assets.

The table below analyses the movements in the Bank's gold investment assets:

For the financial year ended 31 March

SDR millions	**2006**	2005
Balance at beginning of year	1,646.5	1,780.7
Net change in gold investment assets		
Deposits placed	382.0	400.5
Disposals of gold	(187.2)	(108.6)
Maturities and other net movements	(382.7)	(402.6)
	(187.9)	(110.7)
Net change in transactions awaiting settlement	103.5	–
Gold price movement	697.4	(23.5)
Balance at end of year	**2,259.5**	1,646.5

At 1 April 2005 the Bank's gold investment assets amounted to 180 tonnes of fine gold. During the financial

year ended 31 March 2006 15 tonnes were disposed of (see note 30). The balance at 31 March 2006 amounted to 165 tonnes of fine gold.

7. Currency banking and investment assets

A. Total holdings

Currency banking and investment assets comprise treasury bills, securities purchased under resale agreements, fixed-term loans, and government and other securities. Banking assets comprise those assets that represent the reinvestment of customer deposits. Investment assets comprise the investments funded by the Bank's own equity.

Currency banking assets are designated as fair value through profit and loss. Currency investment assets are designated as available for sale.

Securities purchased under resale agreements ("reverse repurchase agreements") are transactions under which the Bank places a fixed-term deposit with a counterparty which provides collateral in the form of securities. The rate on the deposit is fixed at the beginning of the transaction, and there is an irrevocable commitment to return the equivalent securities subject to the repayment of the deposit. During the term of the agreement the fair value of collateral is monitored, and additional collateral is obtained where appropriate to protect against credit exposure.

Fixed-term loans are investments made with central banks, international institutions and commercial banks. These include advances to central banks and international institutions as part of committed and uncommitted standby facilities. The balance sheet total "Time deposits and advances to banks" also includes call and notice accounts (see note 8).

Government and other securities are investments made with central banks, international institutions and commercial banks and include fixed and floating rate bonds and asset-backed securities.

The table below analyses the Bank's holdings of currency banking and investment assets:

As at 31 March	**2006**			2005		
SDR millions	Banking assets	Investment assets	Total	Banking assets	Investment assets	Total
Treasury bills	**47,311.9**	**–**	**47,311.9**	31,307.4	–	31,307.4
Securities purchased under resale agreements	**18,296.8**	**1,222.4**	**19,519.2**	13,071.5	962.8	14,034.3
Fixed-term loans and advances to banks	**85,066.9**	**–**	**85,066.9**	77,336.8	–	77,336.8
Government and other securities						
Government	3,469.0	6,717.5	10,186.5	7,766.3	5,569.7	13,336.0
Financial institutions	24,617.4	957.5	25,574.9	16,629.7	876.4	17,506.1
Other (including public sector securities)	7,578.4	1,096.6	8,675.0	7,934.2	1,003.3	8,937.5
	35,664.8	**8,771.6**	**44,436.4**	32,330.2	7,449.4	39,779.6
Total currency banking and investment assets	**186,340.4**	**9,994.0**	**196,334.4**	154,045.9	8,412.2	162,458.1

B. Currency investment assets

The Bank's investment assets are designated as available for sale.

Note 21A provides further analysis of the securities revaluation account. Note 29 provides further analysis of the net gain on sales of investment securities.

The table below analyses the movements in the Bank's currency investment assets:

For the financial year ended 31 March

SDR millions	**2006**	2005
Balance at beginning of year	8,412.2	8,762.6
Net change in currency investment assets		
Additions	21,358.5	14,133.8
Disposals	(3,214.1)	(3,384.2)
Maturities and other net movements	(16,467.5)	(10,956.8)
	1,676.9	(207.2)
Net change in transactions awaiting settlement	43.2	(63.9)
Fair value and other movements	(138.3)	(79.3)
Balance at end of year	**9,994.0**	8,412.2

8. Time deposits and advances to banks

Time deposits and advances to banks comprise fixed-term loans and call and notice accounts.

Fixed-term loans are designated as fair value through profit and loss.

Call and notice accounts are designated as loans and receivables and are included as cash and cash equivalents. These are very short-term financial assets, typically having a notice period of three days or less. These are included in the balance sheet at amortised cost.

As at 31 March

SDR millions	**2006**	2005
Fixed-term loans and advances to banks	85,066.9	77,336.8
Call and notice accounts	2,831.6	2,979.7
Total time deposits and advances to banks	**87,898.5**	80,316.5

9. Derivative financial instruments

The Bank uses the following types of derivative instruments for economic hedging and trading purposes.

Interest rate and bond futures are contractual obligations to receive or pay a net amount based on changes in interest rates or bond prices on a future date at a specified price established in an organised market. Futures contracts are collateralised by cash or marketable securities and changes in the futures contract value are settled daily with the exchange.

Currency and bond options are contractual agreements under which the seller grants the purchaser the right, but not the obligation, to either buy (call option) or sell (put option), by or on a set date, a specific amount of a currency, a bond or gold at a predetermined price. In consideration, the seller receives a premium from the purchaser.

Options on futures are contractual agreements that confer the right, but not the obligation, to buy or sell a futures contract at a predetermined price during a specified period of time.

Currency and gold swaps, cross-currency interest rate swaps and interest rate swaps are commitments to exchange one set of cash flows for another. Swaps result in an economic exchange of currencies, gold or interest rates (for example, fixed rate for floating rate) or a combination of interest rates and currencies (cross-currency interest rate swaps). Except for certain currency and gold swaps and cross-currency interest rate swaps, no exchange of principal takes place.

Currency and gold forwards represent commitments to purchase foreign currencies or gold at a future date. This includes undelivered spot transactions.

Forward rate agreements are individually negotiated interest rate forward contracts that result in cash settlement at a future date for the difference between a contracted rate of interest and the prevailing market rate.

Swaptions are options under which the seller grants the purchaser the right, but not the obligation, to enter into a currency or interest rate swap at a predetermined price by or on a set date.

The table below analyses the fair value of derivative financial instruments:

As at 31 March	2006			2005		
	Notional amounts	Fair values		Notional amounts	Fair values	
SDR millions		Assets	Liabilities		Assets	Liabilities
Bond futures	381.3	–	(0.4)	721.1	1.0	(1.2)
Bond options	168.0	–	(1.5)	82.7	0.7	–
Cross-currency interest rate swaps	8,058.3	189.2	(803.8)	10,619.0	246.7	(2,221.7)
Currency and gold forwards	4,212.5	18.8	(29.4)	1,297.6	16.0	(9.0)
Currency options	213.3	–	(0.3)	2,276.2	0.7	(4.4)
Currency and gold swaps	38,674.9	460.5	(142.4)	31,993.1	480.6	(145.3)
Forward rate agreements	37,290.0	11.9	(7.5)	45,074.2	5.3	(3.2)
Interest rate futures	42,923.3	0.1	(0.3)	19,195.0	1.4	(0.2)
Interest rate swaps	250,096.2	1,274.3	(1,668.6)	202,919.6	1,433.8	(1,038.5)
Options on futures	15,228.8	1.2	(0.2)	3,306.0	0.9	(0.5)
Swaptions	1,803.2	–	(20.5)	2,818.0	0.9	(16.6)
Total derivative financial instruments at end of year	**399,049.8**	**1,956.0**	**(2,674.9)**	320,302.5	2,188.0	(3,440.6)
Net derivative financial instruments at end of year			**(718.9)**			(1,252.6)

10. Accounts receivable

As at 31 March

SDR millions	**2006**	2005
Financial transactions awaiting settlement	7,436.4	4,018.1
Other assets	8.3	10.5
Total accounts receivable	**7,444.7**	4,028.6

"Financial transactions awaiting settlement" relates to short-term receivables (typically due in three days or less) where transactions have been effected but cash has not yet been transferred. This includes assets that have been sold and liabilities that have been issued.

11. Land, buildings and equipment

For the financial year ended 31 March				2006	2005
SDR millions	Land	Buildings	IT and other equipment	Total	Total
Historical cost					
Balance at beginning of year	41.2	185.1	86.2	312.5	314.4
Capital expenditure	–	–	12.6	12.6	14.9
Disposals and retirements	–	–	(0.6)	(0.6)	(16.8)
Balance at end of year	**41.2**	**185.1**	**98.2**	**324.5**	312.5
Depreciation					
Accumulated depreciation at beginning of year	–	72.5	50.8	123.3	124.4
Depreciation	–	4.0	9.3	13.3	15.7
Disposals and retirements	–	–	(0.5)	(0.5)	(16.8)
Balance at end of year	**–**	**76.5**	**59.6**	**136.1**	123.3
Net book value at end of year	**41.2**	**108.6**	**38.6**	**188.4**	189.2

The depreciation charge for the financial year ended 31 March 2006 includes an additional charge of SDR 1.0 million following an impairment review (2005: SDR 2.4 million).

Following a review of capitalised costs in the financial year ended 31 March 2005, SDR 16.8 million was derecognised from capitalised yet fully depreciated IT and other equipment costs.

12. Currency deposits

Currency deposits are book entry claims on the Bank and are analysed in the table below:

As at 31 March

SDR millions	2006	2005
Deposit instruments repayable at one to two days' notice		
Medium-Term Instruments (MTIs)	57,688.3	42,694.7
FIXBIS	50,327.0	53,712.0
	108,015.3	96,406.7
Other currency deposits		
FRIBIS	3,247.1	3,192.4
Fixed-term deposits	52,181.5	36,987.3
Sight and notice deposits	22,547.6	14,032.4
	77,976.2	54,212.1
Total currency deposits	**185,991.5**	150,618.8
Comprising:		
Designated as held at fair value through profit and loss	163,443.9	136,586.4
Designated as loans and receivables	22,547.6	14,032.4

Medium-Term Instruments (MTIs) are fixed rate investments at the BIS for quarterly maturities of up to 10 years. The Bank also offers MTIs which are callable at an exercise price of par at the option of the Bank (callable MTIs), with call dates between April 2006 and March 2007 (2005: April 2005 and March 2007). The amount of callable MTIs in the balance sheet as at 31 March 2006 was SDR 6,262.9 million (2005: SDR 3,720.1 million).

FIXBIS are fixed rate investments at the BIS for any maturities between one week and one year.

FRIBIS are floating rate investments at the BIS with maturities of one year or longer for which the interest rate is reset in line with prevailing market conditions.

Fixed-term deposits are fixed rate investments at the BIS, typically with a maturity of less than one year. The Bank also takes fixed-term deposits that are repayable on the maturity date either in the original currency or at a fixed amount in a different currency at the option of the Bank (dual currency deposits). The amount of dual currency deposits included in the balance sheet at 31 March 2006 was SDR 231.1 million (2005: SDR 1,096.4 million). The maturity dates of these deposits are between April and June 2006 (2005: April and September 2005).

Sight and notice deposits are very short-term financial liabilities, typically having a notice period of three days or less. They are designated as loans and receivables and are included in the balance sheet at amortised cost.

The Bank has undertaken to repay at fair value certain deposit instruments, in whole or in part, at one to two business days' notice. As a result of this activity the Bank incurs realised profits or losses, which are included under the profit and loss account heading "Net valuation movement".

In accordance with the Bank's risk management policies the market risk inherent in this activity is managed on an overall fair value basis, combining all the relevant assets, liabilities and derivatives in its currency banking portfolios. The realised and unrealised profits or losses on currency deposit liabilities are thus largely offset by realised and unrealised losses or profits on currency banking assets, derivatives or other currency deposit liabilities.

To reduce the accounting inconsistency that would otherwise arise from recognising realised and unrealised gains and losses on different bases, the Bank designates all of the relevant assets and liabilities in its currency banking portfolios as held at fair value through profit and loss.

Currency deposits (other than sight and notice deposits) are included in the balance sheet at fair value. This value differs from the amount that the Bank is contractually required to pay at maturity to the holder of the deposit. For total currency deposits the amount that the Bank is contractually required to pay at maturity to the holder of the deposit, plus accrued interest to 31 March 2006, is SDR 187,896.6 million (2005: SDR 151,115.9 million).

The Bank uses financial models to estimate the fair value of its currency deposits. These models value the expected cash flows of financial instruments using discount factors that are derived partly from quoted interest rates (eg Libor and swap rates) and partly from assumptions about spreads. The Bank determines these spreads based on recent market transactions. In the financial year ended 31 March 2006, changes to the assumptions about spreads used for valuing currency deposits decreased the Bank's profit by SDR 6.0 million (2005: decreased profit by SDR 7.9 million).

13. Gold deposit liabilities

Gold deposits placed with the Bank originate entirely from central banks. They are all designated as loans and receivables.

14. Securities sold under repurchase agreements

Securities sold under repurchase agreements ("repurchase agreements") are transactions under which the Bank receives a fixed-term deposit from a counterparty to which it provides collateral in the form of securities. The rate on the deposit is fixed at the beginning of the transaction, and there is an irrevocable commitment to repay the deposit subject to the return of equivalent securities. They originate entirely from commercial banks.

As at 31 March 2006 and 2005 all of the securities sold under repurchase agreements were associated with the management of currency investment assets. They are therefore all designated as loans and receivables and are included in the balance sheet at amortised cost.

15. Accounts payable

Accounts payable consist of financial transactions awaiting settlement, relating to short-term payables (typically payable within three days or less) where transactions have been effected but cash has not yet been transferred. This includes assets that have been purchased and liabilities that have been repurchased.

16. Other liabilities

As at 31 March

SDR millions	**2006**	2005
Post-employment benefit obligations (see note 22)		
Directors' pensions	4.1	4.2
Health and accident benefits	135.1	127.3
Payable to former shareholders	2.4	3.9
Other	27.8	15.9
Total other liabilities	**169.4**	151.3

17. Share capital

The Bank's share capital consists of:

As at 31 March

SDR millions	**2006**	2005
Authorised capital: 600,000 shares, each of SDR 5,000 par value	3,000.0	3,000.0
Issued capital: 547,125 shares	2,735.6	2,735.6
Paid-up capital (25%)	**683.9**	683.9

The number of shares eligible for dividend is:

As at 31 March	**2006**	2005
Issued shares	547,125	547,125
Less: shares held in treasury	(1,000)	(36,933)
Outstanding shares eligible for dividend	**546,125**	510,192
Of which:		
Eligible for full dividend	510,192	470,073
Eligible for dividend pro rata from the value date of subscription	35,933	40,119
Dividend per share (in SDR)	**245**	235

The shares eligible for dividend pro rata from the value date of subscription reflect the redistribution of shares held in treasury (see note 19).

18. Statutory reserves

The Bank's Statutes provide for application of the Bank's annual net profit by the Annual General Meeting on the proposal of the Board of Directors to three specific reserve funds: the legal reserve fund, the general reserve fund and the special dividend reserve fund; the remainder of the net profit after payment of any dividend is generally allocated to the free reserve fund.

Legal reserve fund. This fund is currently fully funded at 10% of the Bank's paid-up capital.

General reserve fund. After paying any dividend, 10% of the remainder of the Bank's annual net profit currently must be allocated to the general reserve fund. When the balance of this fund equals five times the Bank's paid-up capital, such annual contribution will decrease to 5% of the remainder of the annual net profit.

Special dividend reserve fund. A portion of the remainder of the annual net profit may be allocated to the special dividend reserve fund, which shall be available, in case of need, for paying the whole or any part of a declared dividend. Dividends are normally paid out of the Bank's net profit.

Free reserve fund. After the above allocations have been made, any remaining unallocated net profit is generally transferred to the free reserve fund.

Receipts from the subscription of BIS shares are allocated to the legal reserve fund as necessary to keep it fully funded, with the remainder being credited to the general reserve fund.

The free reserve fund, general reserve fund and legal reserve fund are available, in that order, to meet any losses incurred by the Bank. In the event of liquidation of the Bank, the balances of the reserve funds (after the discharge of the liabilities of the Bank and the costs of liquidation) would be divided among the Bank's shareholders.

19. Repurchase and subsequent redistribution of shares

The Extraordinary General Meeting on 8 January 2001 amended the Bank's Statutes to restrict the right to hold shares in the BIS exclusively to central banks, thereby effecting a mandatory repurchase from private (ie non-central bank) shareholders of 72,648 shares on which the American, Belgian and French central banks exercise voting rights. At the same time the Bank repurchased 2,304 shares of these three issues from other central banks. The total compensation paid was CHF 23,977.56 per share plus interest thereon.

The Bank held these shares in treasury and redistributed 40,119 of them, corresponding to the shares of the Belgian and French issues held in treasury, during the financial year ended 31 March 2005 to the central banks of those countries. The Bank redistributed the remaining 35,933 shares of the American issue held in treasury by selling them to shareholding central banks on 31 May 2005 (see note 20).

20. Shares held in treasury

For the financial year ended 31 March	**2006**	2005
Balance at beginning of year		
Repurchase of shares in the financial year ended 31 March 2001	34,833	74,952
Others	2,100	2,100
Total at beginning of year	36,933	77,052
Redistribution to shareholding central banks	(35,933)	(40,119)
Balance at end of year	**1,000**	36,933

In accordance with the Bank's Statutes, the BIS shares repurchased in early 2001 and subsequently held in treasury (see note 19) may be redistributed by the Board of Directors by way of sale to shareholding central banks against payment of an amount equal to that of the compensation paid to the former shareholders (ie CHF 23,977.56 per share). Consistent therewith, during the financial year ended 31 March 2005, the Bank redistributed all treasury shares of the Belgian and French issues by selling them to the central banks of those countries. The proceeds of this sale of 40,119 shares amounted to CHF 962.0 million, equivalent to SDR 536.7 million at the relevant transaction dates.

On 31 May 2005 the Bank redistributed the remaining 35,933 shares of the American issue held in treasury by selling them to shareholding central banks at a price of CHF 23,977.56 per share. The proceeds of this sale amounted to CHF 861.6 million, equivalent to SDR 468.2 million at the transaction date.

These amounts were credited to the Bank's equity accounts as follows:

For the financial year ended 31 March

SDR millions	**2006**	2005
Shares held in treasury	396.2	456.4
General reserve fund – exchange adjustment	72.0	80.3
Total	**468.2**	536.7

The figure of SDR 396.2 million (2005: SDR 456.4 million) represents the SDR equivalent of the cost of the compensation in Swiss francs paid to the former shareholders of the shares at the time of the shares repurchase in January 2001 and the final award of the Hague Arbitral Tribunal in September 2003. For more information on the Hague Arbitral Tribunal, see last year's financial statements, note 17. When the sale proceeds of these shares were received, an exchange gain of SDR 72.0 million (2005: SDR 80.3 million) was realised. This resulted from the appreciation of the Swiss franc against the SDR during the period from 2001 to the dates of sale.

The remaining shares held in treasury consist of 1,000 suspended shares of the Albanian issue.

During the financial year ended 31 March 2006 a loan from the Bank to a consortium of central banks that related to the suspended shares of the Albanian issue was reclassified from accounts receivable to shares held in treasury. The amount reclassified was SDR 1.7 million.

21. Other equity accounts

Other equity accounts represent the revaluation accounts of the currency and gold investment assets, which are further described in notes 6 and 7.

Other equity accounts comprise:

As at 31 March

SDR millions	**2006**	2005
Securities revaluation account	(104.3)	92.2
Gold revaluation account	1,342.2	759.3
Total other equity accounts	**1,237.9**	851.5

A. Securities revaluation account

This account contains the difference between the fair value and the amortised cost of the Bank's investment securities.

The movements in the securities revaluation account were as follows:

For the financial year ended 31 March

SDR millions	**2006**	2005
Balance at beginning of year	92.2	178.5
Net valuation movement		
Net gain on sales	(58.2)	(7.0)
Fair value and other movements	(138.3)	(79.3)
	(196.5)	(86.3)
Balance at end of year	**(104.3)**	92.2

The tables below analyse the balance in the securities revaluation account:

As at 31 March 2006 *SDR millions*	Fair value of assets	Historical cost	Securities revaluation account	Gross gains	Gross losses
Securities purchased under resale agreements	1,222.4	1,222.5	(0.1)	–	(0.1)
Government and other securities	8,771.6	8,875.8	(104.2)	48.6	(152.8)
Total	**9,994.0**	**10,098.3**	**(104.3)**	**48.6**	**(152.9)**

As at 31 March 2005 *SDR millions*	Fair value of assets	Historical cost	Securities revaluation account	Gross gains	Gross losses
Securities purchased under resale agreements	962.8	962.8	–	–	–
Government and other securities	7,449.4	7,357.2	92.2	137.9	(45.7)
Total	8,412.2	8,320.0	92.2	137.9	(45.7)

B. Gold revaluation account

This account contains the difference between the book value and the deemed cost of the Bank's gold investment assets. For gold investment assets held on 31 March 2003 (when the Bank changed its functional and presentation currency from the gold franc to the SDR) the deemed cost is approximately SDR 151 per ounce, based on the value of USD 208 that was applied from 1979 to 2003 in accordance with a decision by the Bank's Board of Directors, translated at the 31 March 2003 exchange rate.

The movements in the gold revaluation account were as follows:

For the financial year ended 31 March

SDR millions	**2006**	2005
Balance at beginning of year	759.3	833.3
Net valuation movement		
Net gain on sales	(114.5)	(50.5)
Gold price movement	697.4	(23.5)
	582.9	(74.0)
Balance at end of year	**1,342.2**	759.3

22. Post-employment benefit obligations

The Bank operates three post-employment arrangements:

1. A final salary defined benefit pension arrangement for its staff. The pension arrangement is based on a fund without separate legal personality, out of which benefits are paid. The fund assets are administered by the Bank for the sole benefit of current and former members of staff who participate in the arrangement. The Bank remains ultimately liable for all benefits due under the arrangement.

2. An unfunded defined benefit arrangement for its directors, whose entitlement is based on a minimum service period of four years.

3. An unfunded post-employment health and accident benefit arrangement for its staff. Entitlement to this arrangement is based in principle on the employee remaining in service up to 50 years of age and the completion of a minimum service period of 10 years.

All arrangements are valued annually by independent actuaries.

In addition, the Bank operates a blocked personal deposit account for certain staff members who were previously members of the Bank's savings fund, which closed on 1 April 2003. The terms of these blocked accounts are such that staff members cannot make further deposits and balances are paid out when they leave the Bank. The accounts bear interest at a rate determined by the Bank based on the rate offered by the Swiss National Bank on similar staff accounts. The total balance of blocked accounts at 31 March 2006 was SDR 19.4 million (2005: SDR 21.2 million). They are reported under the balance sheet heading "Currency deposits".

A. Amounts recognised in the balance sheet

As at 31 March	Staff pensions		Directors' pensions		Post-employment health and accident benefits	
SDR millions	**2006**	2005	**2006**	2005	**2006**	2005
Present value of obligation	(606.4)	(596.4)	(4.5)	(4.3)	(183.8)	(179.8)
Fair value of fund assets	602.2	566.6	–	–	–	–
Funded status	(4.2)	(29.8)	(4.5)	(4.3)	(183.8)	(179.8)
Unrecognised actuarial losses	46.8	77.9	0.3	0.1	57.2	62.4
Unrecognised past service cost	(42.6)	(48.1)	–	–	(8.6)	(9.9)
Liability at end of year	**–**	–	**(4.2)**	(4.2)	**(135.2)**	(127.3)

B. Present value of benefit obligation

The reconciliation of the opening and closing amounts of the present value of the benefit obligation is as follows:

As at 31 March	Staff pensions		Directors' pensions		Post-employment health and accident benefits	
SDR millions	**2006**	2005	**2006**	2005	**2006**	2005
Present value of obligation at beginning of year	596.4	527.8	4.3	4.6	179.8	129.3
Current service cost	26.3	23.3	0.2	0.2	7.5	7.7
Employee contributions	3.2	3.2	–	–	–	–
Interest cost	18.5	18.9	0.1	0.2	5.7	4.7
Actuarial loss	9.8	24.6	–	0.1	–	43.4
Effect of plan changes	–	–	–	–	–	(9.9)
Benefit payments	(23.3)	(25.3)	(0.3)	(0.3)	(1.8)	(1.7)
Exchange differences	(24.5)	23.9	0.2	(0.5)	(7.4)	6.3
Present value of obligation at end of year	**606.4**	596.4	**4.5**	4.3	**183.8**	179.8

C. Fair value of fund assets for staff pensions

The reconciliation of the opening and closing amounts of the fair value of fund assets for the staff pension arrangement is as follows:

For the financial year ended 31 March

SDR millions	**2006**	2005
Fair value of fund assets at beginning of year	566.6	525.4
Expected return on fund assets	27.4	27.3
Asset gain / (loss)	36.8	(2.7)
Employer contributions	15.0	15.1
Employee contributions	3.2	3.2
Benefit payments	(23.3)	(25.3)
Exchange differences	(23.5)	23.6
Fair value of fund assets at end of year	**602.2**	566.6

D. Amounts recognised in the profit and loss account

For the financial year ended 31 March	Staff pensions		Directors' pensions		Post-employment health and accident benefits	
SDR millions	**2006**	2005	**2006**	2005	**2006**	2005
Current service cost	26.3	23.3	0.2	0.2	7.5	7.7
Interest cost	18.5	18.9	0.1	0.1	5.7	4.7
Less: expected return on fund assets	(27.4)	(27.3)	–	–	–	–
Less: past service cost	(3.4)	0.2	–	–	(1.0)	–
Net actuarial losses recognised in year	1.2	–	–	–	2.8	0.3
Total included in operating expense	**15.2**	15.1	**0.3**	0.3	**15.0**	12.7

E. Major categories of fund assets as a percentage of total fund assets

As at 31 March

Percentages	**2006**	2005
European equities	16.1	15.7
Other equities	28.5	25.6
European fixed income	26.9	28.2
Other fixed income	24.0	23.5
Other assets	4.5	7.0
Actual return on fund assets	10.65%	4.30%

The staff pension fund does not invest in financial instruments issued by the Bank.

F. Principal actuarial assumptions used in these financial statements

As at 31 March

	2006	2005
Applicable to all three post-employment benefit arrangements		
Discount rate – market rate of highly rated Swiss corporate bonds	3.25%	3.25%
Applicable to staff and directors' pension arrangements		
Assumed increase in pensions payable	1.50%	1.50%
Applicable to staff pension arrangement only		
Expected return on fund assets	5.00%	5.00%
Assumed salary increase rate	4.10%	4.10%
Applicable to directors' pension arrangement only		
Assumed directors' pensionable remuneration increase rate	1.50%	1.50%
Applicable to post-employment health and accident benefit arrangement only		
Long-term medical inflation assumption	5.00%	5.00%

The assumed increases in staff salaries, directors' pensionable remuneration and pensions payable incorporate an inflation assumption of 1.5%.

The expected rate of return on fund assets is based on long-term expectations for inflation, interest rates, risk premiums and asset allocations. The estimate takes into consideration historical returns and is determined in conjunction with the fund's independent actuaries.

The assumption for medical inflation has a significant effect on the amounts recognised in the profit and loss account. A 1% change in the assumption for medical inflation compared to that used for the 2005/06 calculation would have the following effects:

SDR millions	6% medical inflation	4% medical inflation
Increase / (decrease) of the total service and interest cost for the financial year ended 31 March 2006	4.3	(3.2)
Increase / (decrease) of the benefit obligation as at 31 March 2006	46.4	(37.8)

23. Interest income

For the financial year ended 31 March

SDR millions	2006	2005
Currency investment assets designated as available for sale		
Securities purchased under resale agreements	39.9	14.5
Government and other securities	287.1	255.4
	327.0	269.9
Currency banking assets designated as held at fair value through profit and loss		
Treasury bills	465.3	335.5
Securities purchased under resale agreements	104.8	81.6
Time deposits and advances to banks	3,221.3	1,636.7
Government and other securities	1,058.4	767.5
	4,849.8	2,821.3
Assets designated as loans and receivables		
Call and notice accounts	96.6	56.7
Gold investment assets	20.4	23.4
Gold banking assets	7.0	7.2
	124.0	87.3
Derivative financial instruments designated as held at fair value through profit and loss	**936.7**	879.5
Other interest	**1.6**	0.8
Total interest income	**6,239.1**	4,058.8
Of which:		
Interest received during the financial year	6,392.4	3,981.1

24. Interest expense

For the financial year ended 31 March

SDR millions	**2006**	2005
Liabilities designated as loans and receivables		
Interest on gold deposits	5.4	5.8
Interest on sight and notice deposits	462.1	272.7
Interest on securities sold under repurchase agreements	37.0	13.5
	504.5	292.0
Liabilities designated as held at fair value through profit and loss		
Interest on other currency deposits	5,064.3	3,091.5
Interest on securities sold under repurchase agreements	0.3	0.6
	5,064.6	3,092.1
Total interest expense	**5,569.1**	3,384.1
Of which:		
Interest paid during the financial year	5,434.9	3,320.7

25. Net valuation movement

For the financial year ended 31 March

SDR millions	**2006**	2005
Unrealised valuation movements on currency banking assets	(332.9)	(247.9)
Realised gains on currency banking assets	4.3	20.9
Unrealised valuation movements on financial liabilities	498.2	1,478.0
Realised gains / (losses) on financial liabilities	63.0	(16.7)
Valuation movements on derivative financial instruments	(306.7)	(1,417.4)
Net valuation movement	**(74.1)**	(183.1)

26. Net fees and commissions income

For the financial year ended 31 March

SDR millions	**2006**	2005
Fees and commissions income	5.8	4.3
Fees and commissions expense	(3.1)	(3.0)
Net fees and commissions income	**2.7**	1.3

27. Net foreign exchange loss

For the financial year ended 31 March

SDR millions	**2006**	2005
Net transaction (loss) / gain	(23.4)	11.9
Net translation loss	(1.8)	(46.4)
Net foreign exchange loss	**(25.2)**	(34.5)

The net loss in the financial year ended 31 March 2006 resulted principally from the impact of an appreciating gold price on the market value of forward contracts for the sale of gold investment assets. This loss was offset by a corresponding increase in the realised gain on the Bank's sales of gold investment assets (see note 30) when these transactions were settled.

The net loss in the financial year ended 31 March 2005 was attributable principally to the impact of the appreciation of the Swiss franc against the SDR on the Bank's short Swiss franc position which existed prior to the subscription by the central banks of Belgium and France for the shares of their national issues which were formerly held in treasury. On the date of subscription, this loss (and the related translation losses in prior years since these shares were repurchased from private shareholders in 2001) was offset in the Bank's equity by a realised exchange gain of SDR 80.3 million (see note 20).

28. Operating expense

The following table analyses the Bank's operating expense in Swiss francs (CHF), the currency in which most expenditure is incurred:

For the financial year ended 31 March

CHF millions	**2006**	2005
Board of Directors		
Directors' fees	1.7	1.6
Pensions to former directors	0.6	0.6
Travel, external Board meetings and other costs	1.1	1.0
	3.4	3.2
Management and staff		
Remuneration	102.3	97.1
Pensions	31.4	30.9
Other personnel-related expense	42.6	38.3
	176.3	166.3
Office and other expense	**68.9**	64.5
Administrative expense in CHF millions	**248.6**	234.0
Administrative expense in SDR millions	133.6	129.3
Depreciation in SDR millions	13.3	15.7
Operating expense in SDR millions	**146.9**	145.0

The average number of full-time equivalent employees during the financial year ended 31 March 2006 was 520 (2005: 526).

29. Net gain on sales of investment securities

For the financial year ended 31 March

SDR millions	**2006**	2005
Disposal proceeds	3,214.1	3,384.2
Amortised cost	(3,155.9)	(3,377.2)
Net gains	**58.2**	7.0
Comprising:		
Gross realised gains	64.1	32.9
Gross realised losses	(5.9)	(25.9)

30. Net gain on sales of gold investment assets

The profits on the sales of gold investment assets for the financial year ended 31 March 2006 were as follows:

For the financial year ended 31 March

SDR millions	**2006**	2005
Disposal proceeds	187.2	108.6
Deemed cost (see note 21B)	(72.7)	(58.1)
Gross realised gains	**114.5**	50.5

31. Earnings per share

For the financial year ended 31 March	**2006**	2005
Net profit for the financial year (SDR millions)	599.2	370.9
Weighted average number of shares entitled to dividend	540,535	486,673
Basic and diluted earnings per share (SDR per share)	**1,108.5**	762.1

The dividend proposed for the financial year ended 31 March 2006 is SDR 245 per share (2005: SDR 235).

32. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise:

As at 31 March

SDR millions	**2006**	2005
Cash and sight accounts with banks	33.0	25.8
Call and notice accounts	2,831.6	2,979.7
Total cash and cash equivalents	**2,864.6**	3,005.5

33. Taxes

The Bank's special legal status in Switzerland is set out principally in its Headquarters Agreement with the Swiss Federal Council. Under the terms of this document the Bank is exempted from virtually all direct and indirect taxes at both federal and local government level in Switzerland.

Similar agreements exist with the government of the People's Republic of China for the Asian Office in Hong Kong SAR and with the Mexican government for the Office of the Americas.

34. Exchange rates

The following table shows the principal rates and prices used to translate balances in foreign currency and gold into SDR:

	Spot rate as at 31 March		Average rate for the financial year ended	
	2006	2005	**2006**	2005
USD	0.694	0.661	0.687	0.671
EUR	0.840	0.859	0.835	0.845
JPY	0.00589	0.00619	0.00607	0.00625
GBP	1.205	1.248	1.225	1.238
CHF	0.532	0.554	0.539	0.549
Gold	404.4	282.7	327.7	277.9

35. Off-balance sheet items

Fiduciary transactions are effected in the Bank's name on behalf of, and at the risk of, the Bank's customers without recourse to the Bank.

They are not included in the Bank's balance sheet and comprise:

As at 31 March *SDR millions*	**2006**	2005
Nominal value of securities held under:		
Safe custody arrangements	10,413.8	10,009.2
Collateral pledge agreements	2,220.5	2,275.2
Portfolio management mandates	5,012.1	3,769.4
Total	**17,646.4**	16,053.8

The financial instruments held under the above arrangements are deposited with external custodians, either central banks or commercial institutions.

36. Commitments

The Bank provides a number of committed standby facilities for its central bank and international institution customers. As at 31 March 2006 the outstanding commitments to extend credit under these committed standby facilities amounted to SDR 7,470.4 million (2005: SDR 5,480.4 million), of which SDR 344.0 million was uncollateralised (2005: SDR 315.0 million).

37. Effective interest rates

The effective interest rate is the rate that discounts the expected future cash flows of a financial instrument to the current book value.

The tables below summarise the effective interest rate by major currencies for applicable financial instruments:

As at 31 March 2006

Percentages	USD	EUR	GBP	JPY	Other currencies
Assets					
Gold deposits	–	–	–	–	0.61
Treasury bills	4.77	2.39	–	0.02	1.06
Securities purchased under resale agreements	4.78	2.63	4.57	–	–
Time deposits and advances to banks	4.75	2.51	4.59	–	4.25
Government and other securities	4.76	3.41	4.80	0.60	4.99
Liabilities					
Currency deposits	4.23	2.55	4.32	–	4.85
Gold deposits	–	–	–	–	0.28
Securities sold under repurchase agreements	4.63	–	4.27	–	–

As at 31 March 2005

Percentages	USD	EUR	GBP	JPY	Other currencies
Assets					
Gold deposits	–	–	–	–	0.82
Treasury bills	2.70	2.13	–	–	–
Securities purchased under resale agreements	2.71	2.12	4.79	–	–
Time deposits and advances to banks	2.77	2.24	4.93	–	4.15
Government and other securities	3.63	3.14	4.96	0.45	3.94
Liabilities					
Currency deposits	3.00	2.29	4.73	–	3.29
Gold deposits	–	–	–	–	0.46
Securities sold under repurchase agreements	2.43	–	–	–	–

38. Concentration analysis

A. Total liabilities

As at 31 March

SDR millions	2006	2005
Africa	18,260.7	14,024.8
Asia-Pacific	84,594.8	80,642.4
Europe	60,380.7	41,772.5
North and South America	41,394.6	28,910.3
International organisations	3,914.3	4,883.1
Total	**208,545.1**	170,233.1

The Bank's currency and gold deposits, principally from central banks and international institutions, comprise 93.6% (2005: 92.7%) of its total liabilities. At 31 March 2006 currency and gold deposits originated from 154 depositors (2005: 159). Within these deposits there are significant individual customer concentrations, with five customers each contributing in excess of 5% of the total on a settlement date basis (2005: three customers). Note 4 provides details of how the Bank manages the concentration risk in its funding base.

B. Credit commitments

As at 31 March

SDR millions	2006	2005
Asia-Pacific	7,166.4	5,259.1
Europe	304.0	221.3
Total	**7,470.4**	5,480.4

Note 36 provides further analysis of the Bank's credit commitments.

C. Off-balance sheet items

As at 31 March

SDR millions	2006	2005
Africa	975.2	594.6
Asia-Pacific	13,410.4	12,144.1
Europe	560.2	556.8
North and South America	2,700.6	2,758.3
Total	**17,646.4**	16,053.8

Note 35 provides further analysis of the Bank's off-balance sheet items.

D. Total assets

The Bank invests the majority of its funds in the interbank market (with G10 based global financial institutions) and in G10 sovereign debt. A geographical analysis of the Bank's total assets is not provided because the Bank's Management believes that this would not present a fair impression of the economic effect of the Bank's investments.

39. Related parties

The Bank considers the following to be its related parties:

- The members of the Board of Directors;
- The senior officials of the Bank;
- Close family members of the above individuals;
- Enterprises which could exert significant influence over a member of the Board of Directors or senior official and enterprises over which one of these individuals could exert significant influence;
- The Bank's post-employment benefit arrangements; and
- Central banks whose governor is a member of the Board of Directors and institutions that are connected with these central banks.

A listing of the members of the Board of Directors and senior officials is shown in the section of the Annual Report entitled "Board of Directors and senior officials". Note 22 provides details of the Bank's post-employment benefit arrangements.

A. Related party individuals

The total compensation of senior officials recognised in the profit and loss account amounted to:

For the financial year ended 31 March

CHF millions	2006	2005
Salaries, allowances and medical cover	6.4	6.7
Post-employment benefits	1.8	1.8
Total compensation in CHF millions	**8.2**	8.5
SDR equivalent	4.4	4.6

Note 28 provides details of the total compensation of the Board of Directors.

The Bank offers personal deposit accounts for all staff members and its Directors. In addition, the Bank operates a blocked personal deposit account for certain staff members who were previously members of the Bank's savings fund. The terms of these blocked accounts are such that staff members cannot make further deposits and balances are paid out when they leave the Bank. The personal deposit accounts and the blocked accounts bear interest at a rate determined by the Bank based on the rate offered by the Swiss National Bank on similar staff accounts. At 31 March 2006, the movements and total balance on personal deposit and blocked accounts relating to members of the Board of Directors and the senior officials of the Bank were as follows:

For the financial year ended 31 March

CHF millions	**2006**	2005
Balance at beginning of year	18.7	19.8
Deposits taken including interest income (net of withholding tax)	6.6	6.2
Withdrawals	(12.0)	(7.3)
Balance at end of year in CHF millions	**13.3**	18.7
SDR equivalent	7.1	10.4
Interest expense on deposits in CHF millions	0.5	0.8
SDR equivalent	0.3	0.4

Balances related to individuals who are appointed as members of the Board of Directors or as senior officials of the Bank during the financial year are included in the table above along with other deposits taken. Balances related to individuals who cease to be members of the Board of Directors or senior officials of the Bank during the financial year are included in the table above along with other withdrawals.

B. Related party central banks and connected institutions

The BIS provides banking services to central banks, international organisations and other public institutions. In fulfilling this role, the Bank in the normal course of business enters into transactions with related party central banks and connected institutions. These transactions include making advances, and taking currency and gold deposits.

It is the Bank's policy to enter into transactions with related party central banks and connected institutions on similar terms and conditions to transactions with other, non-related party customers.

Currency deposits from related party central banks and connected institutions

For the financial year ended 31 March

SDR millions	**2006**	2005
Balance at beginning of year	39,806.9	34,030.3
Deposits taken	175,323.0	104,844.2
Maturities, repayments and fair value movements	(156,074.1)	(101,906.6)
Net movement on call / notice accounts	(5,775.8)	2,839.0
Balance at end of year	**53,280.0**	39,806.9
Percentage of total currency deposits at end of year	28.6%	26.4%

Gold deposits from related party central banks and connected institutions

For the financial year ended 31 March

SDR millions	**2006**	2005
Balance at beginning of year	4,808.6	5,049.1
Deposits taken	–	154.3
Net withdrawals and gold price movements	1,458.7	(394.8)
Balance at end of year	**6,267.3**	4,808.6
Percentage of total gold deposits at end of year	67.9%	67.6%

Securities purchased under resale transactions with related party central banks and connected institutions

For the financial year ended 31 March

SDR millions	**2006**	2005
Balance at beginning of year	4,917.3	4,448.0
Deposits taken	1,095,001.1	1,200,762.4
Maturities and fair value movements	(1,096,719.9)	(1,200,293.1)
Balance at end of year	**3,198.5**	4,917.3
Percentage of total securities purchased under resale agreements at end of year	16.4%	35.0%

Other balances with related party central banks and connected institutions

The Bank maintains sight accounts in currencies with related party central banks and connected institutions, the total balance of which was SDR 10.8 million as at 31 March 2006 (2005: SDR 7.4 million). Gold held in sight accounts with related party central banks and connected institutions totalled SDR 7,132.0 million as at 31 March 2006 (2005: SDR 5,170.3 million).

Derivative transactions with related party central banks and connected institutions

The BIS enters into derivative transactions with its related party central banks and connected institutions, including foreign exchange deals and interest rate swaps. The total nominal value of these transactions with related party central banks and connected institutions during the year ended 31 March 2006 was SDR 10,948.1 million (2005: SDR 4,184.5 million).

40. Contingent liabilities

The Bank is involved in two separate legal proceedings (in addition to the proceedings before the Hague Arbitral Tribunal that were completed in 2003) arising out of the decision of 8 January 2001 to repurchase all BIS shares then held by private shareholders (see note 19).

A group of former private shareholders initiated a legal proceeding in December 2001 before the Commercial Court in Paris. That Court made a preliminary determination (without addressing the substance of the matter) in March 2003 that it had jurisdiction over claims seeking to increase the amount of compensation. The Bank subsequently requested review of this procedural decision by the Paris Court of Appeals, arguing that the Hague Arbitral Tribunal had exclusive jurisdiction over the matter. In a decision rendered on 25 February 2004, the Paris Court of Appeals ruled in favour of the Bank by concluding that the Paris Commercial Court had no jurisdiction over such claims. In April 2004, a small group of former private shareholders petitioned the French Cour de Cassation to quash the ruling of the appeals court on the jurisdiction issue. Written arguments regarding the jurisdiction issue were filed by both the claimants and the Bank in late 2004, and a decision of the court is pending. The Bank considers this action to be without merit. Accordingly, no separate provision has been made for these claims.

A separate proceeding was filed by a group of claimants who purport to have sold BIS shares on the markets during the period between the announcement of the share withdrawal proposal on 11 September 2000 and the 8 January 2001 Extraordinary General Meeting decision effectuating such withdrawal. The claim was brought not against the BIS, but rather against JP Morgan & Cie SA and Barbier Frinault, the Bank's financial advisers for determining the original compensation for the transaction. That notwithstanding, the Bank faces indirect liability through an indemnification clause in the contract with JP Morgan & Cie SA with respect to litigation and costs that might arise in connection with the financial advisory services performed. No provision has been made for this claim.

Aside from the foregoing, no significant litigation or arbitration procedure involving the BIS is currently under way.

Report of the auditors

Report of the auditors
to the Board of Directors and to the General Meeting
of the Bank for International Settlements, Basel

We have audited the accompanying financial statements (pages 190–224) of the Bank for International Settlements. These financial statements incorporate the balance sheet and profit and loss account, as required by the Bank's Statutes, and the notes thereto. The financial statements have been prepared by the Management of the Bank in accordance with the Statutes and with the principles of valuation described under significant accounting policies in the notes. Our responsibility under the Statutes of the Bank is to form an independent opinion on the balance sheet and profit and loss account based on our audit and to report our opinion to you. The prior year financial statements were audited by another auditor whose report dated 9 May 2005 expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by Management, as well as evaluating the overall financial statement presentation. We have received all the information and explanations which we have required to obtain assurance that the balance sheet and profit and loss account are free of material misstatement, and believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements, including the notes thereto, have been properly drawn up and give a true and fair view of the financial position of the Bank for International Settlements at 31 March 2006 and the results of its operations for the year then ended in conformity with the accounting principles described in the notes to the financial statements and the Statutes of the Bank.

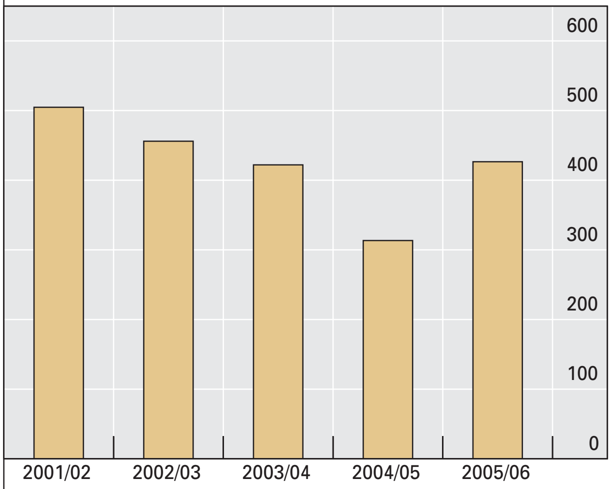
Deloitte AG

Dr. Philip Göth — Pavel Nemecek

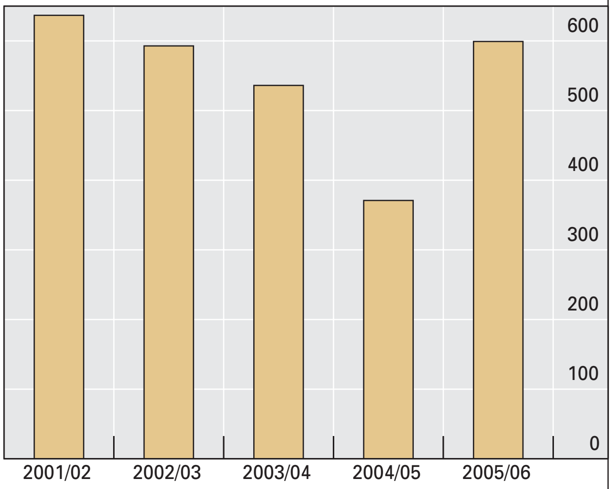
Zurich, 8 May 2006

Five-year graphical summary

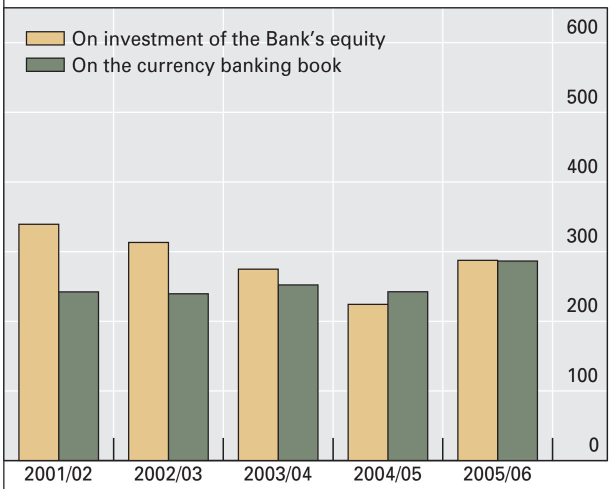
Operating profit
SDR millions



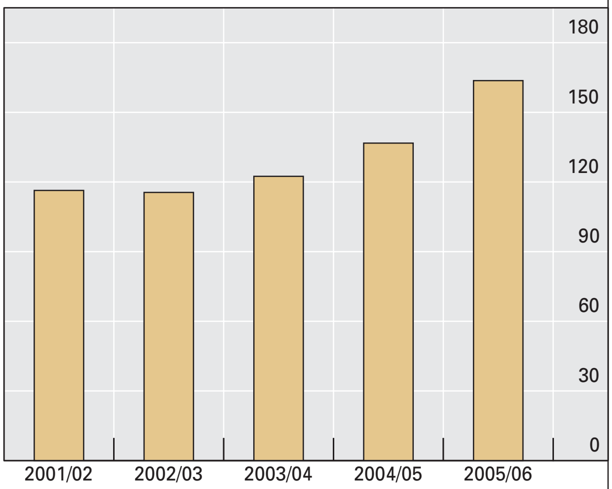
Net profit
SDR millions



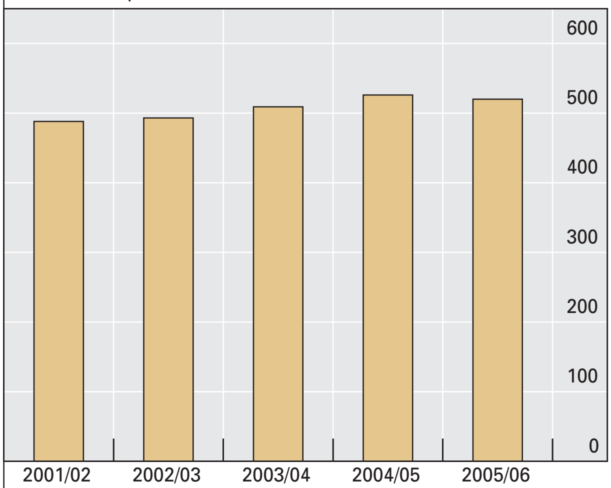
Net interest earned on currency investments
SDR millions



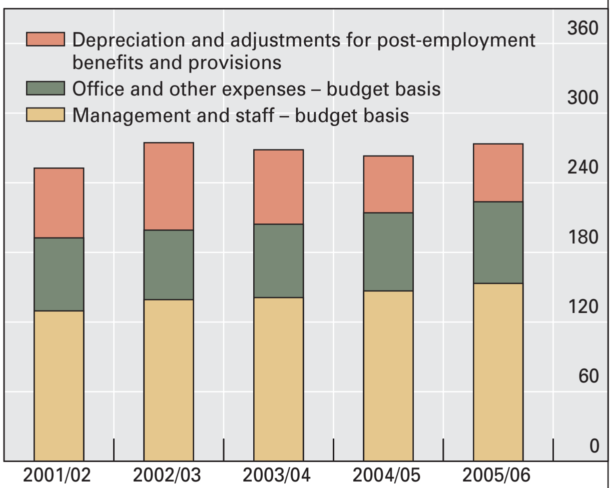
Average currency deposits (value date accruals basis)
SDR billions



Average number of employees
Full-time equivalent



Operating expense
CHF millions



Note: The financial information for 2001/02 is based on best estimates.

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