Contents

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 560 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 were 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.

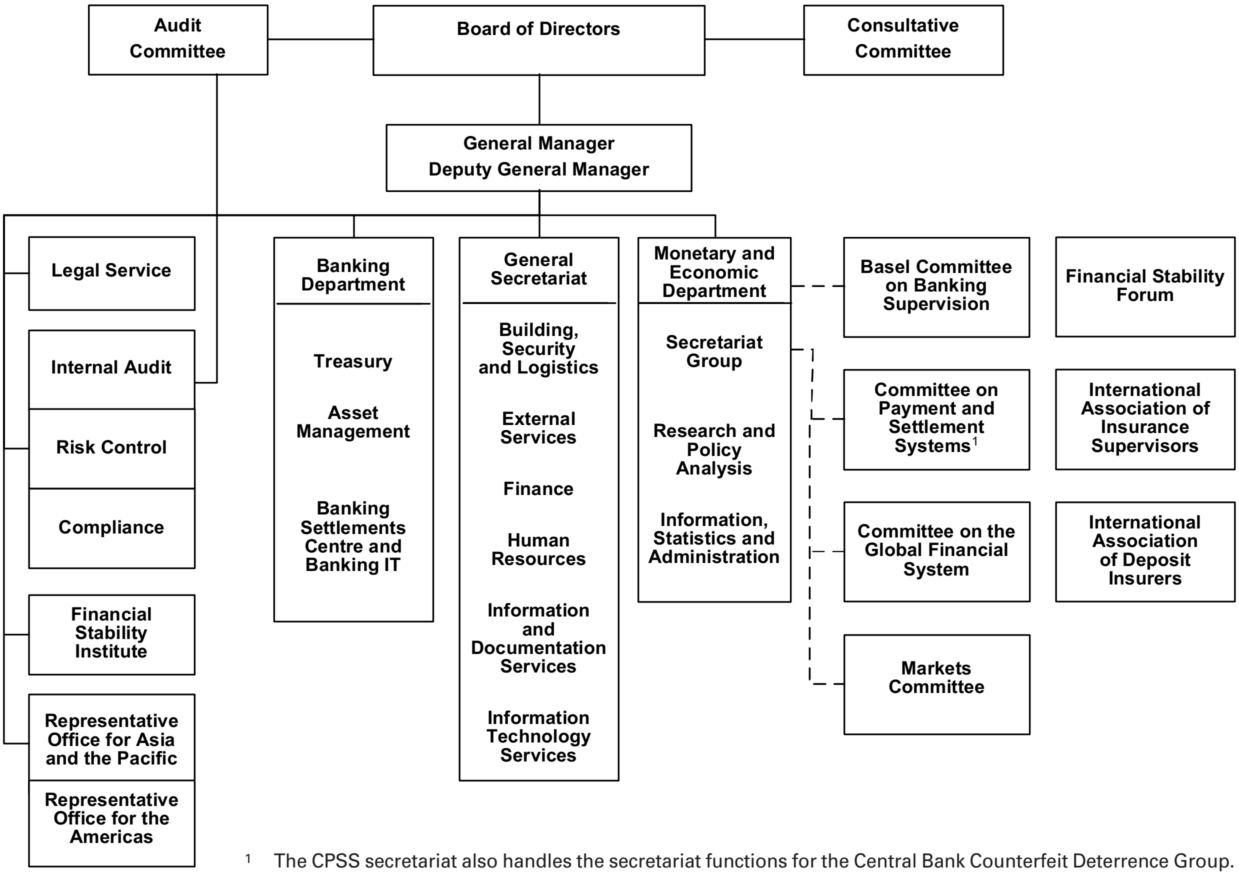
There are three main bodies for governing and administering the Bank:

- 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 2004, 113 central banks took part, including 93 at Governor level. Delegates from 19 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;
- 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.

In the past year, the Bank undertook a review of its governance to determine how far it is consistent with current principles of sound corporate governance, taking due account of the specific features and missions of the BIS as an international organisation. The review identified some divergences between the Bank's Statutes and its current governance practice, resulting in a lack of transparency as to the allocation of responsibility for decision-making at the Bank. Subsequently, a committee consisting of selected Board members was set up by the Board to make concrete proposals. The committee recommended a number of amendments to the Bank's Statutes, which the Board endorsed. The amendments are principally intended to make the Bank's governance more transparent by bringing the Statutes into line with existing governance practice. On the proposal of the Board, these amendments will be submitted for approval by the member central banks at an Extraordinary General Meeting to be held on the same date as the Bank's 2005 Annual General Meeting.

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 2005



[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 2004/05

75 years of central bank cooperation

2005 sees the 75th anniversary of the founding of the BIS. The Bank was established pursuant to the Second Hague Conference on 20 January 1930 and officially commenced operations in Basel on 17 May 1930. The BIS is marking the occasion with a number of special events. In May the Cambridge University Press published *Central bank cooperation at the Bank for International Settlements, 1930–1973*, an independent study commissioned by the BIS in 1999 from Gianni Toniolo (Professor of Economics at the Università di Roma Tor Vergata, Italy), assisted by Piet Clement (Historian at the BIS). In connection with the publication of this book, the Bank is organising a private academic conference, *Past and future of central bank cooperation*.

The Bank is also mounting its first ever public exhibition, entitled "this is the biz" (a play on the German abbreviation for BIS). The two-week exhibition in the Bank's Tower premises in Basel explores the origins of the BIS, traces its development from a largely European to a global institution and illustrates its role today in fostering cooperation among central banks and other official bodies responsible for monetary and financial stability.

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 – the latter initiated in March 2005 and expected to convene three times a year – 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 was initiated in January 2004 to brief 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 2004/05 Governors discussed:

- The changing interest rate environment in emerging market economies
- Central banks and the insurance industry
- Basel II implementation issues
- Detecting vulnerabilities in the emerging market economies
- Central banks and the prevention of banknote counterfeiting
- The BIS international financial statistics

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

- The evolving role of credit rating agencies in financial markets
- "Excess" global liquidity: a problem with policy implications?
- How much capital do central banks need?
- The design and operation of monetary policy decision-making bodies
- Is a new order for the global monetary system emerging?

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. Particular highlights last year were discussions of the implications of the growth of hedge funds for the financial industry and the shift in commercial banks' focus towards retail business.

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

- the biannual central bank economists meeting, which in October 2004 examined the relationship between exchange rates and monetary policy;
- 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 foreign exchange market intervention.

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 of 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). Themes addressed during the past year included:

- the measurement and pricing of credit risk as it relates to individual borrowers, the financial sector and countries as a whole ("country risk"), and as reflected in the decisions of individual financial firms and markets more generally;
- the behaviour of property prices, especially residential real estate prices, and their implications for the macroeconomy and the financial sector; and
- the need for coordination between monetary and prudential policies.

The BIS again organised special events to strengthen contacts with the academic community. In June 2004, it hosted a conference on "Understanding low inflation and deflation", highlighting the economic forces behind these developments and their policy implications. In September, it held a workshop on "The pricing of credit risk", taking stock of the latest developments in this area.

A new international initiative during the year was the creation of a new economic publication, the *International Journal of Central Banking*, sponsored widely within the central banking community, including by the BIS. The primary goal of the journal is to enhance the dissemination of high-quality, policy-relevant research on central banking subjects by both central bank researchers and other scholars. The inaugural issue was published in May 2005.

Cooperation in the statistical area

Last year, the BIS coordinated the fifth triennial survey of foreign exchange and derivatives market activity, with a total of 52 central banks participating. The survey provides extensive location-based data on turnover in these markets in April 2004, as well as data on consolidated amounts outstanding at end-June 2004. The final detailed report was released in March 2005.

The BIS also worked with the G10 central banks, whose banks are active players in the over-the-counter (OTC) derivatives markets, to improve the semiannual collection, compilation and publication of aggregate data on these markets. Data collection on credit default swaps began at the end of 2004. The BIS also began to report data on the concentration of trading activities in the various segments of the OTC markets as from the end of 2004.

Discussions took place with a number of additional central banks and monetary authorities, including from offshore centres, on joining the 38 that currently report aggregate national data on the international lending and borrowing activities of the internationally active banks in their jurisdictions. These statistics are reported on a balance of payments basis as well as on a worldwide consolidated basis, in the latter case providing more detailed information on ultimate risk exposure, including off-balance sheet data, as from the end of 2004.

The geographical coverage of domestic securities issuance now includes five new reporting countries, bringing the total to 47. Moreover, the BIS has agreed to participate in the ECB's Centralised Securities Database, the information in which will complement the data on the 700,000 individual international securities already included in the BIS database.

The BIS banking and securities data form part of the Joint External Debt Statistics, which bring together data on individual countries' external debt available from creditor sources. Last year, the Inter-Agency Task Force on Finance Statistics, in which the BIS participates, worked on the creation of a new Joint External Debt Hub that combines improved creditor-based external debt statistics with external debt data from debtor countries.

Detailed data from the BIS international statistics are made available to the participating central banks in electronic form through the BIS Data Bank, which also includes comprehensive national data on other economic, monetary and financial variables. Last year, two more central banks became active members of the Data Bank, which now covers 34 BIS member central banks in all major regions of the world. The topical coverage of the Data Bank also continued to expand, with additional focus on financial accounts data, macroprudential indicators and real estate prices. In early 2005 all other BIS member central banks were invited to report on a limited number of key statistical indicators for their country through the BIS Data Bank.

The second conference of the Irving Fisher Committee on Central-Bank Statistics (IFC) was held at the BIS in September 2004. The conference focused on price indices; output, output gaps and productivity; and financial accounts. The proceedings were published in various IFC Bulletins. The proceedings of a joint BIS/IMF conference on real estate indicators for financial stability analysis were published in April 2005 in the *BIS Papers* series.

Significant progress was made in international cooperation on electronic standards for statistical information exchange. The Statistical Data and Metadata Exchange (SDMX) initiative, in which the BIS works together with the ECB, Eurostat, IMF, OECD, UN and World Bank, reached agreement on the first version of a set of standards for the web-based exchange of statistical information. The standards were published in September 2004 on the SDMX website (www.sdmx.org) and were approved in April 2005 as a technical specification by the International Organization for Standardization (ISO), thereby anchoring them within the international standards community. Discussions were started with XBRL International, which has developed similar standards for accounting information, in order to ensure that the emerging frameworks for exchanging statistical and accounting data are as compatible as possible.

Central bank governance

The Bank's activities in this area are aimed at enhancing the institutional design and operation of central banks as public policy institutions. In carrying out this work, it is recognised that each country's arrangements need to reflect its economic, institutional and historical context. These activities are under the aegis of the Central Bank Governance Group, which discusses related issues at a senior level and oversees the data collection undertaken through the Network on Central Bank Governance.

The Governance Group is a representative group of Governors from a broad range of central banks. Other central bank Governors are invited from time to time to discuss matters of specific interest to them. During the past year, the Group considered inter alia the services central banks provide to government, the nature of the financial risks that central banks face and how they manage them, and the legal protection central banks need to fulfil their mandates. As advocated by the Governance Group, the Bank prioritises governance questions that are critical for the effective operation of independent and accountable monetary authorities.

The Governance Network now spans more than 45 major central banks and monetary authorities around the world. Members contribute actively to efforts to bring together information on central bank 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 June 2004, the 12th triennial "Automation Days" conference of the Group of Computer Experts was held, hosted by the Swiss National Bank. Presentations and discussions at the conference centred on information technology (IT) management and organisation, security issues, software sourcing and information management. A number of trends are evident:

- There is an increasing focus on identifying and implementing more effective IT governance mechanisms.
- Despite the significant risks involved, central banks are making growing use of the internet to provide information to external customers and other organisations.

- Outsourced solutions are increasingly being chosen to meet greater demand for systems and services while respecting headcount constraints.
- Many central banks are adopting information management systems, with a particular technical and organisational challenge being the implementation of document management technology.

Other topics dealt with at the Group's semiannual meetings included business continuity planning, IT strategy (and its consequences for IT organisation) and mayor ongoing or planned infrastructure and application projects.

With its focus on IT security, the work of the Working Party on Security Issues makes an important contribution to the overall activity of the Group of Computer Experts. During the past year, for example, the Working Party prepared an in-depth report on security concerns raised by the rapid increase in the use of mobile equipment such as laptops and handheld devices by central bank staff.

Internal Audit

Since 1986, G10 central bank auditors have met regularly to exchange professional experience and knowledge, and to address new issues and challenges. Discussions are generally related to international internal auditing standards and the ongoing need to enhance central banks' risk control. Twice a year, the BIS's Internal Audit unit hosts and organises the meetings of the G10 Working Party on IT Audit Methodologies.

In June 2004, the BIS participated in the 18th Annual Conference of G10 Heads of Internal Audit, hosted by the Bank of Italy and covering in particular the role of internal audit in fostering ethics and ethical awareness in an organisation; the implications of the Sarbanes-Oxley Act; the consulting role of internal audit; the role of internal audit for IT governance; and the auditing of business continuity management.

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

Cooperation with regional central bank groupings

Cooperation with various regional central bank groupings offers a useful platform for disseminating information and for developing relations with central banks that do not otherwise participate directly in BIS activities. Accordingly, the Bank organised a variety of joint events with regional groups including:

- a number of meetings with South East Asian Central Banks (SEACEN), in which several BIS speakers participated;
- a joint meeting with the central banks of the Southern African Development Community (SADC) in early 2005; and
- occasional joint events with the Centro de Estudios Monetarios Latinoamericanos (CEMLA); the BIS also provided speakers for CEMLA seminars and workshops.

The BIS continued to support the Centre Africain d'Études Supérieures en Gestion (CESAG), as part of a programme sponsored by, amongst others, the Bank of France, the Central Bank of West African States (BCEAO) and the Bank of Central African States (BEAC). A number of BIS experts were also delegated to training events run by the Macroeconomic and Financial Management Institute of Eastern and Southern Africa (MEFMI). In line with the original agreement, the BIS ceased to be a formal member of the Joint Vienna Institute (JVI) as from August 2004. However, the Bank continues to organise occasional seminars at the JVI for central banks from transition economies.

In addition to their regular annual meeting, the Group of Coordinators of Technical Cooperation and Training organised a one-off meeting of global providers of training to central banks. This meeting took place in Basel in November 2004 and attracted representatives from over 40 institutions providing such support.

Central Bank Research Hub

The BIS website has for many years carried a list of central banks, with links to their websites. In 2004, the BIS introduced the Central Bank Research Hub, a facility that enables internet users to access research published by central banks via the BIS website. These papers can be retrieved using multiple search criteria and automatically delivered through an e-mail notification service. All BIS member central banks have been invited to share their research efforts via the Hub, and thus far central banks from 25 countries have become participants.

Representative Offices

The Representative Office for Asia and the Pacific (Asian Office) and that for the Americas (Americas Office) serve as centres for BIS activities in their respective regions. The Offices aim to strengthen relations and promote cooperation between the BIS and regional central banks and supervisory authorities. To that end, the Offices foster the exchange of information and data, facilitate the organisation of meetings and seminars, and contribute to the Bank's financial and economic research on Asia and the Americas. Research topics last year included trends in regional capital flows, regional currency and non-deliverable forwards markets, the domestic implications of large foreign exchange reserves, and the micro structure of Asian financial markets.

The Offices also support BIS banking services in the Asia-Pacific region and the Americas, and provide assistance through regular visits to reserve managers of central banks. The regional treasury dealing room established in the Asian Office in 2000 further enhances the level and scope of banking services to regional customers through its daily trading activities.

In December 2004, the BIS was appointed as the administrator for the investments of the 11 Executives' Meeting of East Asia-Pacific Central Banks (EMEAP) members in a second Asian Bond Fund, ABF2. The fund will pool international reserves from the central banks and invest in domestic currency bonds issued by sovereign and quasi-sovereign borrowers in eight EMEAP economies. The Bank had already been selected in June 2003 to manage a first Asian Bond Fund, which has similarly pooled reserves from the EMEAP central banks but has limited its investments to bonds denominated in US dollars. To handle the work involved, Bank staffing in Hong Kong has been strengthened significantly. The Asian Office has also supported the effort by providing analytical work on bond markets in the region.

The Asian Consultative Council (ACC), a forum for communication between shareholding central banks in the region and the Board and Management of the BIS, met once in Basel (in June 2004) and again in Hong Kong (in February 2005). Immediately following the ACC meeting in Hong Kong, the seventh Special Meeting of Asian central bank Governors, with the participation of some central bank Governors from outside the region, reviewed the current economic situation and discussed issues related to increasing household indebtedness in the region.

The Asian Office hosted or supported several meetings on specific topics pertaining to monetary policy and financial stability:

- the third meeting of central bank experts on monetary policy operating procedures (April 2004);
- the eighth and ninth meetings of the EMEAP Forum on foreign exchange markets (June and December 2004);
- two meetings on financial stability co-hosted with the Financial Stability Institute and the Basel Committee respectively (July and September 2004);
- two meetings in Beijing, on China's opening of its financial sector and on effective exchange rates (March 2005).

The Americas Office focused its activity during its second year of operation on expanding its contacts with central banks in the region and cooperating more closely with regional central banking groups 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:

- an outreach meeting of the Committee on the Global Financial System on foreign direct investment in the Latin American financial sector (June 2004);
- a meeting of the Working Party on Monetary Policy in Latin America (October 2004);
- a discussion forum on the implementation of Basel II, with regional heads of banking supervision and representatives of the private sector and international financial institutions (December 2004);
- a meeting of regional reserve managers (November 2004);
- a meeting of central bank lawyers from the region (February 2005);
- a meeting on financial integration and monetary policy for open economies (March 2005).

Financial Stability Institute

The Financial Stability Institute (FSI) assists banking and insurance sector supervisors worldwide in improving prudential supervision. To that end, it works to disseminate standards and sound practices, and provides support on a wide range of supervisory topics.

Much of the FSI's outreach is achieved through a programme of high-level meetings, seminars and conferences, both in Basel and at locations around the world. These events offer an opportunity for information sharing, as well as fostering cross-border supervisory contacts and cooperation. In recognition of the continued growth of financial conglomerates and issues related to risk transfer, the Institute also brings together banking and insurance sector supervisors to address topics of mutual concern. During 2004, the FSI organised 56 events on a variety of supervisory topics. Close to 2,000 representatives of central banks and banking and insurance supervisory agencies from all regions of the world participated. In view of the ongoing efforts in many jurisdictions to implement the new Basel II capital adequacy framework, the FSI initiated a series of high-level meetings to promote information exchange among the relevant supervisory authorities on implementation issues and plans.

July 2004 saw the launch of FSI Connect, an online information and learning resource tool for banking supervisors. FSI Connect currently includes more than 80 tutorials covering a wide range of topics for supervisors of all levels of experience and expertise. Further topics will be added and existing tutorials updated periodically. FSI Connect complements the FSI's other activities and will enable the Institute to reach a wider audience of financial sector supervisors. More than 85 central banks and supervisory authorities from approximately 75 jurisdictions currently subscribe to FSI Connect.

Promotion of financial stability through the permanent committees

Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision, under the chairmanship of Governor Jaime Caruana of the Bank of Spain, works to strengthen banking supervisory frameworks, to promote the advancement of risk management in the banking industry and to help improve financial reporting standards.

Implementation of the new international capital standard

The new international framework for regulatory capital standards (commonly referred to as "Basel II") was published in June 2004. Basel II sets out the details of the agreed framework for measuring capital adequacy and the minimum standard to be achieved, which the national supervisory authorities represented on the Committee will propose for adoption in their respective countries starting from 1 January 2007.

When releasing Basel II, the Committee emphasised its intention to maintain its active dialogue with the industry to ensure that the new framework keeps pace with, and can be applied to, ongoing developments in the financial services sector. Given that securities firms as well as banks are interested in the treatment of certain trading activities under Basel II, the Committee has worked with representatives of the International Organization of Securities Commissions (IOSCO) to design proposals that address the issues identified in a prudent and risk-sensitive way. These proposals were released in April 2005 for a seven-week consultation period.

Consistent implementation of Basel II across borders through enhanced supervisory cooperation will become a critical and challenging task in the years ahead. To encourage collaboration and shared approaches, the Committee's Accord Implementation Group (AIG) serves as a forum on implementation matters. One of the main tools that the AIG has used to promote more effective cross-border implementation of Basel II is the development of "real case studies", which have in most instances become actual implementation plans. The primary role of these case studies is to help home and host supervisors gain experience in implementing Basel II on a practical, case by case basis. The AIG is also working on other relevant areas of Basel II implementation, including validation, operational risk and Pillar 2.

Many national supervisors who are not represented in the Committee have already begun to evaluate the suitability of the new framework for banks in their jurisdiction and to plan for the transition to Basel II. In order to further this process, a paper entitled *Implementation of Basel II: practical considerations* was published in July 2004.

Work on accounting, auditing and compliance

Over the past year, the Basel Committee's accounting-related activities have been dominated by efforts to resolve differences of view on the International Accounting Standards Board's (IASB) fair value option. Agreement was reached in early 2005, and the IASB has now approved and issued a final standard which addresses the Committee's essential concerns. The Committee has also taken an active interest in the IASB's project to enhance financial instrument disclosures. Financial reporting transparency will include greatly enhanced disclosures of financial risks and related risk management practices, broadly similar to the principles and requirements under Pillar 3 of Basel II.

For several years the Committee has been actively engaged in the development of a Public Interest Oversight Board (PIOB) to oversee international standard-setting activities undertaken by the International Federation of Accountants (IFAC). The PIOB held its first formal meeting on 1 March 2005. The Committee will monitor and assess the PIOB's performance over the near term.

In response to a rapidly growing need for guidance in the area of compliance, the Committee published, in April 2005, a guidance paper on principles and sound practices for compliance within a regulated banking environment. This paper focuses on maintaining an effective compliance function and underlines the importance of adopting structures, procedures and controls that are appropriate to the organisation and its particular risk profile.

Other issues in banking supervision

As part of its efforts to enhance risk management in banks, the Committee issued *Principles for the management and supervision of interest rate risk*. It also published *Consolidated KYC* (*know your customer*) *risk management*, aimed at providing guidance for banking groups on how to implement an effective group-wide KYC risk management process. The Committee, in collaboration with the principal non-G10 countries, the IMF and the World

Bank, is currently revising the *Basel Core Principles for Effective Banking Supervision* first published in 1997 and the accompanying *Core Principles Methodology* published in 1999. In addition, a working group has been established to review the Committee's guidance on corporate governance. Finally, the Committee, jointly with the Bank of Spain, sponsored the International Conference of Banking Supervisors (ICBS) in September 2004, which was attended by bank supervisors from over 120 countries.

Committee on the Global Financial System

The Committee on the Global Financial System (CGFS), which is chaired by Roger W Ferguson Jr, Vice Chairman of the Board of Governors of the Federal Reserve System, monitors developments in global financial markets for the central bank Governors of the G10 countries. The Committee has a mandate to identify and assess potential sources of stress in global financial markets, to further the understanding of the structural underpinnings of financial markets, and to promote improvements to the functioning and stability of these markets. It fulfils this mandate by way of quarterly monitoring discussions among CGFS members and through coordinated longer-term efforts, including working groups involving central bank staff.

In addition to senior officials from the G10 central banks and the ECB, representatives of a number of central banks from major economies and financial centres regularly attend Committee meetings. In 2005, the People's Bank of China and the Reserve Bank of India began attending.

Monitoring discussions

The Committee's monitoring discussions focused on the broad patterns of macroeconomic and financial market developments over the year. Recurring, interrelated themes were:

- the impact on financial markets of current international imbalances and how possible adjustments might affect the global financial system;
- central bank "exit strategies" from low and stable policy rates or fixed and quasi-fixed exchange rate commitments, including challenges for communication policy and implications for financial markets;
- developments in oil trading and the consequences of elevated medium-term oil prices for growth and inflation;
- forces driving position-taking and pricing in financial markets in a context of ample global liquidity;
- reasons for and implications of historically low levels of forward-looking volatility measures across markets, even in the presence of heightened macroeconomic and financial uncertainties.

Working groups and similar exercises

In January 2005, the CGFS published two working group reports. The first of these, on the role of ratings in structured finance, explores the rapidly evolving markets for structured finance instruments, the central role played by the rating agencies, and the implications for market participants and policymakers.

With its focus on structured finance, the report complements earlier CGFS work in the area of credit risk transfer. The other report, summarising stress testing practice at major financial institutions, includes a survey of stress tests conducted in May 2004. This survey also builds on earlier work by the Committee and furthers its understanding of the vital role played by stress tests in risk management operations.

Further to its March 2004 working group report on foreign direct investment in the financial sector of emerging market economies, the Committee conducted regional follow-up workshops in Korea, Mexico and Poland with central bank officials and market practitioners from these three regions. The CGFS also continued its discussions of the characteristics of various national mortgage markets. A working group on this topic, established in November 2004, is expected to report back to the Committee later this year. Inter alia, the group will explore the significance for housing finance of the introduction of new financial technologies and their implications for national and international financial markets.

In the area of hedge funds, a study group reported on the suitability of commercial hedge fund databases for use in central banks' research and surveillance efforts. In addition, using a reporting template designed by the CGFS, the BIS semiannual OTC derivatives survey has recently been extended to include information on reporters' activities related to credit default swaps.

Committee on Payment and Settlement Systems

The Committee on Payment and Settlement Systems (CPSS) contributes to strengthening the financial market infrastructure through promoting sound and efficient payment and settlement systems. The Committee has further enhanced its cooperation with other international institutions and groupings, and has involved an increasingly wide group of central banks in its activities. Tommaso Padoa-Schioppa, Member of the Executive Board of the ECB, was chairman of the Committee until his retirement on 31 May 2005. He is succeeded as CPSS chairman by Timothy F Geithner, President and Chief Executive Officer of the Federal Reserve Bank of New York.

In November 2004, the CPSS and the IOSCO Technical Committee released a report on *Recommendations for Central Counterparties*. It sets out comprehensive standards for risk management of a central counterparty (CCP) in 15 headline recommendations with accompanying explanations. The report also includes a methodology for assessing the implementation of the recommendations, which identifies key issues and questions and provides guidance on assigning an assessment category. A consultative version of the report was issued in March 2004 and the final publication benefited from substantial input from central banks and securities regulators, as well as operators of and participants in CCPs.

A CCP interposes itself between counterparties in financial transactions, becoming the buyer to the seller and the seller to the buyer. A well designed CCP with appropriate risk management arrangements reduces the risks faced by its participants and contributes to the goal of financial stability. A CCP, however, also concentrates risks and responsibilities for risk management. Therefore, the effectiveness of a CCP's risk control and the adequacy of its financial resources are critical aspects of the infrastructure of the markets it serves.

The Committee also worked during the period under review on the preparation of three other reports – *Central bank oversight of payment and settlement systems*, *General guidance for payment system development* and *New developments in large-value payment systems* – which were published in May this year.

Another part of the Committee's activity relates to the implementation of its strategy, endorsed by the G10 Governors in 1996, to mitigate foreign exchange settlement risk. To this end, it monitors and encourages private sector initiatives in this area.

Finally, the Committee also provides 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, chaired by Sheryl Kennedy, Deputy Governor of the Bank of Canada, groups senior officials from the G10 central banks 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. From time to time, the Committee invites representatives from major countries to join the discussions; in the second half of 2004 the People's Bank of China participated for the first time.

Issues covered in the meetings included:

- reasons for recent large movements in the major bilateral exchange rates;
- the low level of both nominal yields and implied volatility in the major bond markets and the impact of the "search for yield" on credit spreads;
- the financial market impact of foreign exchange reserve accumulation; and
- information sharing among central banks.

Other topics discussed over the year included the effect of the increased presence of hedge funds in financial markets, the financial market impact of changes in pension fund regulations, monetary policy implementation issues and the influence on market functioning of the growth of electronic trading platforms.

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 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 both by participating in meetings as observer and by providing secretariat support together with the IMF and OECD.

In their communiqué issued in October 2004, G10 Ministers and Governors noted that it was important for the IMF to have a strong financial position in order for it to fulfil its responsibilities. Surveillance, conditionality, programme monitoring, debt sustainability analysis in lending decisions, and adherence to the recently agreed exceptional access framework were seen as key elements in this respect.

Another focus of the work of the G10 was on the use of collective action clauses by sovereign bond issuers. The growing tendency of sovereign issuers to include majority action provisions in their bond contracts helps provide an effective means for creditors and debtors to recontract in the event of need. However, debt contracts generally do not yet include provisions that foster early dialogue and communication among creditors and sovereigns or effectively block litigation by individuals.

Finally, in its ongoing work on pensions finance, the G10 is examining the implications of ageing and pensions reform for financial markets.

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 ministries of finance, central banks and financial regulators in key financial centres, as well as representatives of international financial institutions, international supervisory and regulatory standard-setting bodies and central bank expert groupings. More information on the FSF is available at www.fsforum.org.

The FSF meets twice yearly in plenary form, most recently in September 2004 in Washington DC and March 2005 in Tokyo. At these meetings, members discussed macroeconomic and financial developments, the resilience of financial institutions and potential risks to financial stability. They also reviewed international efforts to strengthen financial systems and considered ways to promote these efforts. Specific topics addressed during the year under review were the exposure of the financial system to unexpected shifts in risk appetite and risk-taking, credit risk transfer activity, household risk exposures, the growth of the hedge fund industry and the transparency of the reinsurance sector.

Recently, the FSF has been seeking ways to improve the implementation of regulatory standards in the banking, securities and insurance sectors. In April 2005, the FSF secretariat convened a meeting of standard setters, assessors and national authorities to prepare a review of progress in the implementation of standards and codes, including setting priorities in standards assessments and the availability of resources to assist implementation.

The FSF has also continued to launch and support initiatives to strengthen accounting and auditing standards and practices. With respect to audits, in September 2004 the Forum convened a first meeting of the heads of the newly established independent national auditor oversight bodies in a number of countries. The meeting discussed experiences in setting up new oversight structures, common challenges such as approaches to audit quality inspection and enforcement, and the need for and scope of cooperation and mutual recognition among national oversight bodies. The FSF also worked to support the establishment in March 2005 of the Public Interest Oversight Board to oversee the standard-setting activities of the International Federation of Accountants (IFAC) relating to auditing and assurance practices. In October 2004, the Forum organised with the International Accounting Standards Board and the IFAC a major roundtable to review the challenges and issues associated with the implementation of international accounting and auditing standards.

The FSF has remained engaged in work to improve information sharing and cross-border cooperation between on- and offshore authorities on supervisory and regulatory matters. In March 2005, the FSF initiated a new process to promote further improvements in offshore financial centres, drawing on a set of initiatives by Forum members at both international and national levels, and on earlier relevant steps by the FSF itself.

A further area of interest for the FSF has been the enhancement of international cooperation in business continuity planning for the financial sector. Together with the Bank of England, the Forum organised a workshop on business continuity in July 2004 and assessed various business continuity standards currently in place, in particular with regard to cross-border arrangements. Taking this task forward, the Joint Forum of the Basel Committee, IOSCO and the IAIS is considering developing a set of high-level business continuity principles for financial authorities and industries.

Looking ahead, an important focus of the FSF will be to assess the preparedness of financial institutions, and the wider financial system, to withstand a possible re-emergence of turbulence and increased risk aversion among financial market participants.

Throughout the year, the FSF kept G7 Finance Ministers and central bank Governors and the IMF's International Monetary and Financial Committee informed about financial vulnerabilities and other issues. The Forum also held further regional meetings to foster wider awareness of financial vulnerabilities and the work under way to address them.

International Association of Insurance Supervisors

The International Association of Insurance Supervisors (IAIS) contributes 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 the provision of mutual assistance. In collaboration with other international regulatory bodies, the IAIS has also helped develop principles for the supervision of financial conglomerates. The IAIS also actively participates in the Financial Stability Forum. The steady increase in members and observers reflects a growing recognition of the IAIS mission. More information on the IAIS is available at www.iaisweb.org.

During the past year, the IAIS undertook several key initiatives in the development of insurance standards, in the priority areas of solvency, accounting and reinsurance.

Regarding solvency, a major step was to define a framework for insurance supervision. The framework proposes the development of a common structure and standards for the assessment of insurer solvency with the aim of enhancing transparency and comparability across regulatory regimes.

As regards insurance accounting, the IAIS is in continuous dialogue with the International Accounting Standards Board (IASB). An important part of its work is the preparation of an issues paper examining which methods for evaluating insurance liabilities, consistent with the likely outcome of the IASB Insurance Contracts Phase II, would be acceptable for prudential supervision. In collaboration with other international regulators, the IAIS has also supported the establishment of the Public Interest Oversight Board to oversee the public interest activities of the International Federation of Accountants.

In response to concerns expressed by the FSF that a lack of adequate transparency and public disclosure in the reinsurance industry makes it difficult to assess its potential impact on the insurance sector and on other parts of the financial services industry, the IAIS issued its first global reinsurance market report. Regarding enhanced disclosure by insurers and reinsurers, a standard on disclosure of technical performance in non-life insurance was adopted in 2004, and two further disclosure standards are being prepared on investment performance and on technical performance in life insurance.

The IAIS has also focused on anti-money laundering and combating the financing of terrorism; an insurance core principles self-assessment programme to identify the strengths and weaknesses of insurance industry regulation and supervision in various jurisdictions; and training through seminars, conferences and workshops, often in collaboration with the Financial Stability Institute.

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. IADI's key objectives are to enhance the understanding of common interests and issues related to deposit insurance, and to set out guidance to increase the effectiveness of deposit insurance systems. Currently, 56 organisations (of which 39 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.

During its third year, IADI continued to provide a forum to facilitate wide international contacts among deposit insurers and other interested parties. The third Annual Conference was held in Switzerland in October 2004 and was attended by 145 deposit insurers and policymakers from 47 countries. Regional dissemination was promoted through conferences, seminars, committee meetings and collaborative events in a wide range of countries.

Work is continuing on guidance to improve the effectiveness of deposit insurance systems. The Association published a paper on the establishment and design of deposit insurance systems and another on the development of differential premium systems. IADI has also begun work with the international financial community, on ways to assist policymakers in evaluating the effectiveness of deposit insurance systems. IADI endorsed the conclusions of the APEC Policy Dialogue on Deposit Insurance held in February 2004 and will be developing relevant guidance.

IADI contributed to a new publication by the International Association of Restructuring, Insolvency and Bankruptcy Professionals entitled *Bank Insolvency, an International Guide for Deposit Insurers*, based on survey results from 48 countries. The purpose of the book is to promote discussion between insolvency practitioners and deposit insurers.

The IADI website (www.iadi.org) and a monthly newsletter provide information on activities to members and participants. Quarterly training guides are widely circulated among deposit insurers.

Financial services of the Bank

Banking services

The BIS offers a wide range of financial services 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 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 a broad range of financial products in terms of currency denomination and maturity. In addition to traditional money market placements such as sight/notice accounts and fixed-term deposits, there are two instruments that can be traded (bought and sold back) directly with the Bank:

the Fixed-Rate Investment at the BIS (FIXBIS), with 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 is also part of the standard product range.

The Bank also 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 take the form of either a specific portfolio mandate negotiated between the BIS and a central bank or an open-end fund structure allowing two or more customers to invest in a common pool of assets. Following the creation of the first Asian Bond Fund (ABF1) in July 2003, the 11 members of the EMEAP group of central banks and monetary authorities launched the second stage (ABF2) in December 2004. The BIS acts as manager for ABF1 and as administrator for ABF2.

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

Operations of the Banking Department in 2004/05

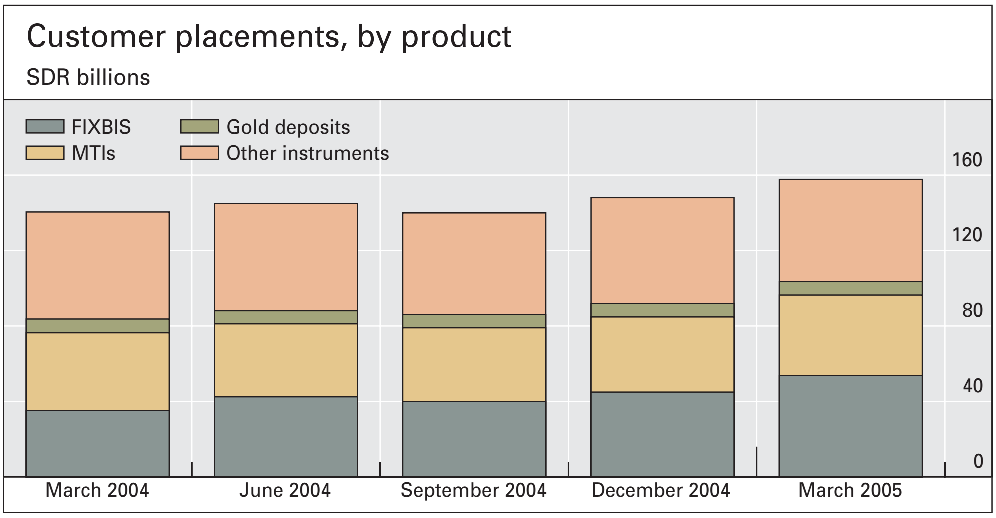
A continued expansion of the BIS balance sheet led to a fifth consecutive record for the end of a financial year. On 31 March 2005, the balance sheet totalled SDR 180.5 billion, representing a year-on-year increase of SDR 12.6 billion or 7.5%. Had exchange rates remained constant throughout the year, the balance sheet would have increased by an additional SDR 0.4 billion.

Liabilities

The size of the BIS balance sheet is mainly determined by placements from customers, which constitute the lion's share of total liabilities. On 31 March 2005, customer placements (excluding repurchase agreements) totalled SDR 157.7 billion, compared with SDR 140.4 billion at the end of the previous financial year.

Most of the customer placements are denominated in various currencies, with the remainder in gold. While gold deposits were largely unchanged at SDR 7.1 billion, customer currency deposits rose from SDR 133.2 billion a year earlier to a total of SDR 150.6 billion at end-March 2005, representing 6% of the world's total foreign currency reserves. Over the year, there was a shift in the currency composition of customer currency deposits, as funds denominated in US dollars rose from 62% to 65% of the total, whereas the share denominated in euros fell from 21% to 18%.

The increase in customer placements was driven by money market investments. Subscriptions to FIXBIS rose by more than 50% to make them the single largest instrument held by BIS customers, representing more than one third of total customer currency deposits. Another substantial increase, of 30%, was recorded in fixed-term deposits. In contrast, balances on sight/notice accounts decreased by more than one third, almost reversing the expansion



observed in the previous financial year. Subscriptions to MTIs, the second largest instrument held by BIS customers, remained relatively stable throughout the financial year (see the graph).

A geographical analysis of currency placements with the BIS shows continued strong demand from Asian customers.

Assets

Most of the BIS assets consist of investments with top-quality commercial banks of international standing and in government and quasi-government securities, including reverse repurchase agreements. The Bank also owns 180 tonnes of fine gold, having disposed of 12 tonnes in the course of the last financial year. The credit exposure is managed in a conservative manner, with over 99% of the Bank's holdings rated A– or higher as at 31 March 2005 (see note 37E to the financial statements).

The Bank's holdings of currency deposits and securities, including reverse repurchase agreements, totalled SDR 165.4 billion on 31 March 2005, up from SDR 153.7 billion at the end of the previous financial year. The additional funds were mainly invested in time deposits with banks, G10 government bonds and, to a lesser extent, Treasury bills. In contrast, there was a SDR 7.8 billion reduction in securities purchased under reverse repurchase agreements.

The Bank uses various derivative instruments in order to manage its assets and liabilities efficiently (see note 7 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 2004 the Bundeswertpapierverwaltung (BWV – German Federal Securities Administration) had arranged for payment of approximately €5.0 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

The BIS acted as escrow agent in connection with the settlement of litigation related to the Pan Am Flight 103 disaster over Lockerbie, Scotland, on 21 December 1988 (see 74th Annual Report of June 2004). This function expired on 17 February 2005.

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. Current collateral pledge agreements include 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

Withdrawal and redistribution of BIS shares

An Extraordinary General Meeting (EGM) of the Bank held on 8 January 2001 decided to amend the Bank's Statutes to restrict the right to hold shares in the BIS exclusively to central banks, thereby effecting a mandatory repurchase of the 72,648 BIS shares of the Belgian, French and American issues that were then held by private shareholders (described in detail in the *71st Annual Report* of June 2001). The withdrawn shares were subsequently held by the Bank in treasury, together with 2,304 shares of the three share issues repurchased from central banks at the time of the withdrawal operation.

The amount of compensation payable to registered former private shareholders was established initially by the EGM at 16,000 Swiss francs per share. Certain former private shareholders contested this amount by initiating claims before the Arbitral Tribunal provided for by the Hague Agreement, which, pursuant to Article 54 of the Bank's Statutes, has sole jurisdiction to hear disputes between the Bank and its former private shareholders arising from the withdrawal. The Arbitral Tribunal issued a partial award on 22 November 2002 confirming the legality of the mandatory repurchase, but concluded that the compensation should be increased. In its Final Award of 19 September 2003, the Arbitral Tribunal determined the amount of additional compensation due to the claimants (see the *74th Annual Report* of June 2004). In accordance with the Bank's earlier declaration that it would voluntarily apply the decision of the Arbitral Tribunal to all registered former private shareholders in final settlement of all claims, as of 31 March 2005 the additional compensation determined by the Arbitral Tribunal had been paid in respect of more than 99% of the withdrawn shares.

In a legal proceeding in France brought by a separate group of former private shareholders, a decision is pending from the Cour de Cassation (the highest French private-law court) on whether to confirm an earlier ruling that the French courts have no jurisdiction over such claims (see the *74th Annual Report* of June 2004).

The Board of Directors decided during the past financial year to redistribute all 74,952 repurchased shares by offering them for sale to BIS member central banks. In addition, this offer covered 1,100 shares of the American issue also held by the Bank in treasury, which had previously been registered in the name of a consortium of central banks. Consistent with the provisions of the BIS Statutes as amended on 8 January 2001, the sale price for these 76,052 shares was 23,977.56 Swiss francs per share – ie the amount of compensation (minus the interest component) paid to the former private shareholders. During the financial year ended 31 March 2005, the Bank redistributed all treasury shares of the Belgian and French issues to the central banks of those countries. The proceeds of this redistribution of 40,119 shares amounted to 962.0 million Swiss francs, equivalent to SDR 536.7 million, at the relevant transaction dates. At the start of the financial year commencing on 1 April 2005, the Bank sold the remaining BIS shares – 35,933 shares of the American issue – through an offer to member central banks. The proceeds amounted to 861.6 million Swiss francs, equivalent to SDR 468.2 million at the transaction date of 31 May 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 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 expenditure. In common with other organisations comparable to the BIS, Management and staff expenditure, 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. By its nature, capital spending tends to 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 2004/05 amounted to 214.1 million Swiss francs, 2.6% below the budget of 219.8 million Swiss francs.[1] Lower than expected IT and travel expenditure, and the write-back of a provision relating to pre-2003 tax reimbursements to Swiss staff members[2] were the main reasons for the underspend. Capital expenditure, at 27.1 million Swiss francs, was 5.6 million below budget. The projects for the enhancement of the Bank's security systems and the redesign of the main Auditorium were completed within their budget allocations at the end of May 2005. Expenditure in 2004/05 was the closest to the budget achieved in the past few years, and reflected a reduction of the "headroom" in individual budget items. In order to reinforce the tighter budgeting, the Bank's Management has introduced a quarterly monitoring system for the achievement of objectives.

In March 2005, the Board approved an increase in the administrative budget for the financial year 2005/06 of 2.9% to 226.3 million Swiss francs. The capital budget foresees a decrease of 5.7 million Swiss francs to 27.0 million. The emphasis in the 2005/06 budget is on strengthening the Bank's risk management, internal audit and compliance functions, and on continuing efforts to improve security arrangements. The budget also includes a limited increase in headcount at the Asian Office.

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.

The salary structure is adjusted annually for the rate of inflation in Switzerland and the average rise in real salaries in the business sector of major industrial countries. In July 2004, the salary structure was accordingly increased by 1.76%. 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. The BIS does not apply a bonus scheme.

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

[1] The Bank's budgetary accounting is cash-based and excludes certain financial accounting adjustments, principally relating to retirement 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").

[2] These arrangements related to the previous Headquarters Agreement with the Swiss Federal Council, which expired on 1 January 2003.

staff are also entitled to receive an education allowance.[3] 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 2004, the annual remuneration of senior managers before expatriation allowances is based on the following salary structure:

- General Manager 709,849 Swiss francs
- Deputy General Manager 600,641 Swiss francs
- Heads of Department 546,000 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. Since 1 July 2002, the overall fixed annual remuneration paid to the Board of Directors has totalled 844,800 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 777,240 Swiss francs.

Archiving policy

In the interest of openness and to facilitate academic research, the Bank voluntarily granted public access to its historical archive in March 1998. Under the BIS open archive rules, all records relating to the Bank's business and operational activities which are over 30 years old are available for consultation, with the exception of a limited number of records that remain private or confidential even after 30 years. The BIS determines at its discretion which records will not be released for public consultation, to protect personal privacy and/or legitimate third-party interests.

Net profit and its distribution

Net profit

The net profit for the 75th financial year amounted to SDR 370.9 million, compared with SDR 536.1 million for the preceding year. The factors behind this outcome are discussed below.

Total operating income

Total operating income amounted to SDR 458.4 million in the financial year 2004/05, compared with SDR 564.5 million in the previous year. There were three principal reasons for this development:

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

- Lower interest yields and valuation adjustments on derivatives contracts, taken out to protect the Bank against expected interest rate increases, reduced income from the Bank's own funds investment securities. These factors outweighed the additional income from the increase in the Bank's equity attributable to retained profits and share subscriptions.
- Net income from the Bank's deposit-taking business returned to more normal levels in 2004/05. The previous year's results had been boosted by an exceptional contribution to profits from the narrowing of credit spreads in summer 2003, which gave rise to revaluation gains in the Bank's asset swap investments. This factor outweighed the additional income from the growth in the Bank's deposit base.
- A net foreign exchange loss of SDR 34.5 million was mainly attributable to the Bank's position in Swiss francs prior to the subscription in October and November 2004 by the National Bank of Belgium and the Bank of France for the BIS shares of their national issues that were formerly held in treasury. This foreign exchange loss was fully offset by a corresponding gain which, in accordance with the Bank's accounting policies, was recorded in equity when these shares were redistributed so that the net impact on the Bank's equity was zero.

Operating expense

Operating expense (see note 27 to the financial statements) amounted to SDR 145.0 million, 1.8% above the preceding year's figure of SDR 142.5 million. Administrative expenses before depreciation were SDR 129.3 million, 2.9% above the previous year's figure of SDR 125.6 million. The depreciation charge decreased from SDR 16.9 million to SDR 15.7 million. In terms of Swiss francs, the currency in which most of the Bank's expenditure is incurred, administrative expense before depreciation on the Bank's financial basis of accounting, which includes financial market and actuarial developments, fell by 1.1% from 236.5 million Swiss francs to 234.0 million.

Underlying staff remuneration and pension costs rose broadly in line with the 3.2% increase in average full-time equivalent staff. This increase was partly offset by a write-back of a provision for pre-2003 tax reimbursements to Swiss staff members, under the arrangements in connection with the previous Headquarters Agreement which expired on 1 January 2003. Other personnel-related expense fell as a result of a lower financial accounting charge for health and accident costs.

Operating profit and other profit items

The Bank's operating profit, which reflects the profits of its ongoing business, amounted to SDR 313.4 million, 25.7% lower than the equivalent figure of SDR 422.0 million recorded in 2003/04.

A net gain of SDR 7.0 million was recorded on the sale of investment securities during the year. This reflected the realignment of the portfolio to its underlying benchmark position. The net profit of SDR 154.4 million on the sale of investment securities for the previous financial year had been attributable to the sale of investment securities acquired in a higher interest rate environment.

The realised gain of SDR 50.5 million on sales of gold investment assets during 2004/05 arose from the sale of 12 tonnes from the Bank's total holdings of 192 tonnes at 31 March 2004. There was no change in the Bank's equity as a result of these sales as the gold in the Bank's balance sheet was, in accordance with the Bank's accounting policies, already carried at market value.

The net profit for the previous financial year 2003/04 was arrived at after charges for interest payable and a currency translation loss in connection with the Final Award of the Hague Arbitral Tribunal of 19 September 2003.

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 370.9 million for the financial year 2004/05 be applied by the General Meeting in the following manner:

1. SDR 114.4 million in payment of a dividend of SDR 235 per share;
2. SDR 25.7 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 224.8 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 1 July 2005 to the shareholders whose names were contained in the bank's share register on 31 March 2005 in any constituent currency of the SDR, or in Swiss francs, according to the shareholders' instructions. The proposed dividend of SDR 235 per share for the financial year 2004/05 represents a 4.4% increase over the dividend for 2003/04.

The full dividend will be paid on 470,073 shares. The dividend payable in respect of the 40,119 treasury shares that were redistributed during the financial year will be settled on a pro rata basis according to the relevant value date of redistribution. The number of issued and paid-up shares before the repurchase of shares is 547,125. Of these shares, 36,933 were held in treasury at 31 March 2005, comprising 34,833 shares repurchased from former private shareholders and central banks, and 2,100 other shares. No dividend will be paid on these treasury shares.

Report of the auditors

The Bank's financial statements have been duly audited by PricewaterhouseCoopers AG, who have confirmed that they give a true and fair view of the Bank's financial position at 31 March 2005 and the results of its operations for the year then ended. Their report is to be found immediately following the financial statements.

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

Board of Directors

Nout H E M Wellink, Amsterdam
Chairman of the Board of Directors,
President of the Bank

Hans Tietmeyer, Frankfurt am Main
Vice-Chairman

Vincenzo Desario, Rome
David Dodge, Ottawa
Antonio Fazio, Rome
Toshihiko Fukui, Tokyo
Timothy F Geithner, New York
Lord George, London
Alan Greenspan, Washington
Hervé Hannoun, Paris
Lars Heikensten, Stockholm
Mervyn King, London
Christian Noyer, Paris
Guy Quaden, Brussels
Jean-Pierre Roth, Zurich
Alfons Vicomte Verplaetse, Brussels
Axel A Weber, Frankfurt am Main

Alternates

Bruno Bianchi or Giovanni Carosio, Rome
Roger W Ferguson or Karen H Johnson, Washington
Peter Praet or Jan Smets, Brussels
Jürgen Stark or Stefan Schönberg, 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
André Icard	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
Mario Giovanoli	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 its meeting in November 2004, the Board re-elected Nout Wellink, President of the Netherlands Bank, as Chairman of the Board of Directors and President of the Bank for a further period of three years commencing on 1 March 2005 and expiring on 29 February 2008. At its meeting in March 2005, the Board re-elected Lars Heikensten, Governor of Sveriges Riksbank, as a member of the Board of Directors for a further three years, ending on 31 March 2008. At the same meeting, Mervyn King, Governor of the Bank of England, reappointed Lord George as a member of the Board of Directors for a further period of three years, expiring on 6 May 2008.

As regards the senior officials of the Bank, upon the retirement of Gunter Baer, Peter Dittus was appointed as the Bank's Secretary General and Chief Administrative Officer on 1 January 2005. Günter Pleines was appointed Head of Banking Department, upon the retirement of Robert Sleeper, from 1 April 2005. Jim Etherington became Deputy Secretary General on 1 June 2005. Louis de Montpellier was appointed as Deputy Head of Banking Department as from mid-June 2005. All new appointments of senior officials are on a five-year renewable basis.

The Board noted with deep regret the death of Baron Cecil de Strycker, Honorary Governor of the National Bank of Belgium, on 5 September 2004 at the age of 89. Baron de Strycker had served on the Board as an ex officio Director between 1975 and 1982 and from 1982 until 1989 as an appointed Director.

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

Bank of Greece

Hong Kong Monetary Authority

Central Bank of 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

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.

Board of Directors

Nout H E M Wellink, Amsterdam
Chairman of the Board of Directors,
President of the Bank

Hans Tietmeyer, Frankfurt am Main
Vice-Chairman

Vincenzo Desario, Rome
David Dodge, Ottawa
Antonio Fazio, Rome
Toshihiko Fukui, Tokyo
Timothy F Geithner, New York
Lord George, London
Alan Greenspan, Washington
Hervé Hannoun, Paris
Lars Heikensten, Stockholm
Mervyn King, London
Christian Noyer, Paris
Guy Quaden, Brussels
Jean-Pierre Roth, Zurich
Alfons Vicomte Verplaetse, Brussels
Axel A Weber, Frankfurt am Main

Alternates

Bruno Bianchi or Giovanni Carosio, Rome
Roger W Ferguson or Karen H Johnson, Washington
Peter Praet or Jan Smets, Brussels
Jürgen Stark or Stefan Schönberg, 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
André Icard	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
Mario Giovanoli	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 its meeting in November 2004, the Board re-elected Nout Wellink, President of the Netherlands Bank, as Chairman of the Board of Directors and President of the Bank for a further period of three years commencing on 1 March 2005 and expiring on 29 February 2008. At its meeting in March 2005, the Board re-elected Lars Heikensten, Governor of Sveriges Riksbank, as a member of the Board of Directors for a further three years, ending on 31 March 2008. At the same meeting, Mervyn King, Governor of the Bank of England, reappointed Lord George as a member of the Board of Directors for a further period of three years, expiring on 6 May 2008.

As regards the senior officials of the Bank, upon the retirement of Gunter Baer, Peter Dittus was appointed as the Bank's Secretary General and Chief Administrative Officer on 1 January 2005. Günter Pleines was appointed Head of Banking Department, upon the retirement of Robert Sleeper, from 1 April 2005. Jim Etherington became Deputy Secretary General on 1 June 2005. Louis de Montpellier was appointed as Deputy Head of Banking Department as from mid-June 2005. All new appointments of senior officials are on a five-year renewable basis.

The Board noted with deep regret the death of Baron Cecil de Strycker, Honorary Governor of the National Bank of Belgium, on 5 September 2004 at the age of 89. Baron de Strycker had served on the Board as an ex officio Director between 1975 and 1982 and from 1982 until 1989 as an appointed Director.

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

Bank of Greece

Hong Kong Monetary Authority

Central Bank of 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

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 2005

The financial statements on pages 188–215 for the financial year ended 31 March 2005 were approved on 9 May 2005. 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 27 June 2005.

Nout H E M Wellink President	Malcolm D Knight General Manager

Balance sheet

As at 31 March 2005

SDR millions	Notes	**2005**	2004
Assets			
Cash and sight accounts with banks	4	25.8	18.9
Gold and gold deposits	5	8,617.0	9,073.8
Treasury bills	6	31,307.4	30,240.7
Securities purchased under resale agreements	6	14,034.3	21,835.2
Time deposits and advances to banks	6	80,316.5	68,162.4
Government and other securities	6	39,779.6	33,483.1
Derivative financial instruments	7	2,188.0	3,321.1
Accounts receivable	8	4,028.6	1,609.6
Land, buildings and equipment	9	189.2	190.0
Total assets		**180,486.4**	167,934.8
Liabilities			
Currency deposits	10	150,618.8	133,152.5
Gold deposits	11	7,110.8	7,293.5
Securities sold under repurchase agreements	12	1,159.4	1,225.3
Derivative financial instruments	7	3,440.6	4,339.7
Accounts payable	13	7,752.2	12,169.4
Other liabilities	14	151.3	144.4
Total liabilities		**170,233.1**	158,324.8
Shareholders' equity			
Share capital	15	683.9	683.9
Statutory reserves	16	8,743.2	8,230.8
Profit and loss account		370.9	536.1
Less: shares held in treasury	18	(396.2)	(852.6)
Other equity accounts	20	851.5	1,011.8
Total equity		**10,253.3**	9,610.0
Total liabilities and equity		**180,486.4**	167,934.8

Profit and loss account

For the financial year ended 31 March 2005

SDR millions	Notes	**2005**	2004
Interest income	22	4,058.8	3,493.9
Interest expense	23	(3,384.1)	(2,681.1)
Net valuation movement	24	(183.1)	(258.7)
Net interest income		**491.6**	554.1
Net fee and commission income	25	1.3	1.4
Net foreign exchange (loss) / gain	26	(34.5)	9.0
Total operating income		**458.4**	564.5
Operating expense	27	(145.0)	(142.5)
Operating profit		**313.4**	422.0
Net gain on sales of investment securities	28	7.0	154.4
Net gain on sales of gold investment assets	29	50.5	–
Shares repurchased – impact of arbitral award	17		
Interest expense		–	(32.9)
Currency translation loss		–	(7.4)
Net profit for the financial year		**370.9**	536.1

Statement of cash flows

For the financial year ended 31 March 2005

SDR millions	Notes	**2005**	2004
Cash flow from operating activities			
Operating profit		313.4	422.0
Non-cash flow items included in operating profit			
Depreciation of land, buildings and equipment	9	15.7	16.9
Net change in operating assets and liabilities			
Currency deposits		15,329.4	11,580.7
Currency banking assets		(16,371.2)	(19,669.9)
Gold deposit liabilities		(182.7)	1,270.9
Gold and gold deposit banking assets		322.6	(1,270.2)
Accounts receivable		1.3	19.0
Other liabilities / accounts payable		17.5	(260.1)
Net derivative financial instruments		234.0	1,750.6
Net cash flow from / (used in) operating activities		**(320.0)**	(6,140.1)
Cash flow from / (used in) investing activities			
Net change in currency investment assets	6	207.2	(1,220.6)
Securities sold under repurchase agreements		(65.9)	1,152.1
Net change in gold investment assets	5	110.7	–
Net purchase of land, buildings and equipment	9	(14.9)	(10.5)
Net cash flow from / (used in) investing activities		**237.1**	(79.0)
Cash flow from / (used in) financing activities			
Dividends paid		(104.0)	(97.1)
Issue of shares		–	252.3
Redistribution of shares held in treasury	18	536.7	–
Shares repurchased in 2001 – payments to former shareholders		(10.6)	(348.2)
Net cash flow from / (used in) financing activities		**422.1**	(193.0)
Net effect of exchange rate changes on cash and cash equivalents		(10.1)	61.3
Net movement in cash and cash equivalents		349.3	(6,473.4)
Net increase / (decrease) in cash and cash equivalents		**339.2**	(6,412.1)
Cash and cash equivalents, beginning of the year	30	**2,666.3**	9,078.4
Cash and cash equivalents, end of the year	30	**3,005.5**	2,666.3

Statement of proposed profit allocation

For the financial year ended 31 March 2005

SDR millions	2005
Net profit for the financial year	**370.9**
Transfer to legal reserve fund	–
Proposed dividend:	
SDR 235 per share on 470,073 shares	(110.5)
On 40,119 redistributed treasury shares (pro rata as from the value date of the share subscription)	(3.9)
	(114.4)
Proposed transfers to other reserves:	
General reserve fund	(25.7)
Special dividend reserve fund	(6.0)
Free reserve fund	(224.8)
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 2005

SDR millions	Notes	Legal reserve fund	General reserve fund	Special dividend reserve fund	Free reserve fund	2005 Total statutory reserves
Balance at 31 March 2004		**68.3**	**2,648.7**	**109.5**	**5,404.3**	**8,230.8**
Allocation of 2003/04 profit		–	86.4	20.5	325.2	432.1
Redistribution of shares held in treasury	18	–	80.3	–	–	80.3
Balance at 31 March 2005 per balance sheet before proposed profit allocation		**68.3**	**2,815.4**	**130.0**	**5,729.5**	**8,743.2**
Proposed transfers to reserves	16	–	25.7	6.0	224.8	256.5
Balance at 31 March 2005 after proposed profit allocation		**68.3**	**2,841.1**	**136.0**	**5,954.3**	**8,999.7**

Movements in the Bank's equity

For the financial year ended 31 March 2005

SDR millions	Notes	Share capital	Statutory reserves	Profit and loss	Shares held in treasury	Other equity accounts	Total equity
Equity at 31 March 2003		**661.4**	**7,522.7**	**575.4**	**(739.1)**	**908.8**	**8,929.2**
Payment of 2002/03 dividend		–	–	(97.1)	–	–	(97.1)
Allocation of 2002/03 profit		–	478.3	(478.3)	–	–	–
New shares issued	15	22.5	229.8	–	–	–	252.3
Shares repurchased – impact of arbitral award	17	–	–	–	(113.5)	–	(113.5)
Net valuation movement on gold investment assets	20	–	–	–	–	261.7	261.7
Net valuation movement on investment securities	20	–	–	–	–	(158.7)	(158.7)
Net profit for 2003/04		–	–	536.1	–	–	536.1
Equity at 31 March 2004		**683.9**	**8,230.8**	**536.1**	**(852.6)**	**1,011.8**	**9,610.0**
Payment of 2003/04 dividend		–	–	(104.0)	–	–	(104.0)
Allocation of 2003/04 profit		–	432.1	(432.1)	–	–	–
Redistribution of shares held in treasury	18	–	80.3	–	456.4	–	536.7
Net valuation movement on gold investment assets	20	–	–	–	–	(74.0)	(74.0)
Net valuation movement on investment securities	20	–	–	–	–	(86.3)	(86.3)
Net profit for 2004/05		–	–	370.9	–	–	370.9
Equity at 31 March 2005 per balance sheet before proposed profit allocation		**683.9**	**8,743.2**	**370.9**	**(396.2)**	**851.5**	**10,253.3**
Proposed dividend		–	–	(114.4)	–	–	(114.4)
Proposed transfers to reserves		–	256.5	(256.5)	–	–	–
Equity at 31 March 2005 after proposed profit allocation		**683.9**	**8,999.7**	**–**	**(396.2)**	**851.5**	**10,138.9**

At 31 March 2005 statutory reserves included share premiums of SDR 811.7 million (31 March 2004: 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-six 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

A. Reporting currency

The reporting 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 29 December 2000 and effective 1 January 2001. As currently calculated, one SDR is equivalent to the sum of USD 0.577, EUR 0.426, JPY 21 and GBP 0.0984. The composition of this currency basket is subject to review every five years by the IMF, the next review being in December 2005.

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

B. Currency translation

Financial instruments 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 financial instruments and from the settlement of transactions are recognised in the profit and loss account.

C. Valuation methodology

In general, the Bank values its assets, liabilities and derivatives at market value. To derive market value the Bank uses reliable quoted market prices from active markets. Where these are not available (for instruments such as loans, deposits and non-exchange-traded derivatives) the Bank determines market 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.

D. Financial instruments (other than gold and gold deposits)

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

For all these financial instruments, the historical cost profits resulting from the accrual of interest and the amortisation of premiums paid and discounts received are included in "Interest income" (for assets and derivatives) or "Interest expense" (for liabilities). Realised profits on disposal, buyback and early termination are included under the profit and loss account heading "Net valuation movement".

The Bank includes most financial instruments in its balance sheet on a trade date basis at market value. Derivatives are included as either assets or liabilities, depending on whether the contract has a positive or a negative market value for the Bank. Very short-term financial instruments (both assets and liabilities) are an exception to this general rule of accounting using market values. These financial instruments typically have notice periods of three days or less, and they are included in the balance sheet on a settlement date basis at their principal value plus accrued interest. They are included under the balance sheet headings "Cash and sight accounts with banks" and "Currency deposits".

The treatment of unrealised gains or losses on revaluation is dependent on the designation of the financial instrument, as described below:

1. Currency deposit liabilities and related banking assets and derivatives

The Bank acts as a market-maker in certain of its currency deposit instruments. The market risk inherent in this activity is managed on a macro basis and so the Bank accounts for all these financial instruments at market value, with all movements in value included under the profit and loss account heading "Net valuation movement".

2. Assets, liabilities and derivatives relating principally to the investment of the Bank's equity

These assets are held for the long term, but not necessarily to maturity. They are accounted for as investment assets and are initially included in the balance sheet at cost. They are subsequently revalued to market value, with unrealised gains or losses included in the securities revaluation account, which is reported under the balance sheet heading "Other equity accounts".

The liabilities associated with the management of these assets, principally short-term repurchase agreements, are included in the balance sheet at market value with all movements in value included under the profit and loss account heading "Net valuation movement".

The related derivatives are used to manage the Bank's market risk or for trading purposes. They are included in the balance sheet at market value with all movements in value included under the profit and loss account heading "Net valuation movement".

E. Gold and gold deposits

Gold assets and liabilities 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. Interest on gold deposits is included in interest income (for assets) or interest expense (for liabilities) on an accruals basis.

The Bank's own holdings of gold are classified as investment assets. The excess in value of the Bank's gold investment assets over its cost is taken to the gold revaluation account, 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 reporting 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.

Gains or losses on revaluation of gold deposit liabilities from third parties and the related gold deposit assets are included under the profit and loss account heading "Net valuation movement".

F. 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.

G. 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. Capital expenditure and disposals are translated at the exchange rate prevailing on the date of the transaction.

H. 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 the amount of the obligation can be reasonably estimated.

I. Retirement benefit obligations

The Bank operates a defined benefit pension fund for its staff. It also operates unfunded arrangements for directors' pensions and health and accident insurance for current and former staff members.

Pension fund

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 market 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 annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined from the estimated future cash outflows, using discount interest rates 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 assets or liabilities are included under the headings "Accounts receivable" or "Other liabilities" in the balance sheet.

Unfunded arrangements

The liabilities in respect of the unfunded directors' pension arrangement and health and accident insurance scheme are based on the present value of the defined benefit obligation calculated on an identical basis to the staff pension fund. In the case of the health and accident scheme (where the entitlement 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), the expected costs of these benefits are accrued over the period of employment, using the projected unit credit method. These obligations are valued annually by independent actuaries.

Corridor accounting

Where the defined benefit obligation exceeds the higher of the liability or any assets used to fund the obligation in the financial statements by more than a corridor of 10%, the resulting excess outside the corridor is amortised over the expected remaining working life of the staff concerned.

J. Cash and cash equivalents

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, makes assumptions and exercises judgment. Subsequent actual results could differ materially from those estimates.

4. 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.

5. Gold and gold deposit assets

A. Total gold holdings

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

SDR millions	**2005**	2004
Gold bars held at central banks	5,170.2	5,463.9
Total gold time deposits	3,446.8	3,609.9
Total gold and gold deposit assets	**8,617.0**	9,073.8
Comprising:		
Gold investment assets	1,646.5	1,780.7
Gold and gold deposit banking assets	6,970.5	7,293.1

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 20 provides further analysis of the gold revaluation account. Note 29 provides further analysis of net gains on sales of gold investment assets.

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

SDR millions	**2005**	2004
Balance at 1 April	1,780.7	1,519.0
Net change in gold investment assets		
Deposits placed	400.5	391.9
Disposals of gold	(108.6)	–
Maturities and other net movements	(402.6)	(391.9)
	(110.7)	–
Gold price movement	(23.5)	261.7
Balance at 31 March	**1,646.5**	1,780.7

At 1 April 2004 the Bank's gold investment assets amounted to 192 tonnes of fine gold. During the financial year ended 31 March 2005 12 tonnes were disposed of. Note 29 provides further analysis of these disposals. The balance at 31 March 2005 amounted to 180 tonnes of fine gold.

6. Currency banking and investment assets

A. Total holdings

Currency banking and investment assets comprise treasury bills, securities purchased under resale agreements, time deposits and advances to banks, 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.

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 collateral subject to the repayment of the deposit. During the term of the agreement, the market value of collateral is monitored, and additional collateral is obtained where appropriate to protect against credit exposure.

Time deposits and advances to banks are investments made with central banks, international institutions and commercial banks and include fixed-term loans, notice accounts and advances to central banks and international institutions as part of committed and uncommitted standby facilities. Call and notice accounts are very short-term financial assets, typically having a notice period of three days or less. They are included within "cash equivalents" in the Bank's cash flow statement.

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:

	2005			2004		
SDR millions	Banking assets	Investment assets	Total	Banking assets	Investment assets	Total
Treasury bills	**31,307.4**	**–**	**31,307.4**	30,240.7	–	30,240.7
Securities purchased under resale agreements	**13,071.5**	**962.8**	**14,034.3**	20,609.7	1,225.5	21,835.2
Time deposits and advances to banks						
Fixed-term	77,336.8	–	77,336.8	65,515.0	–	65,515.0
Call and notice accounts	2,979.7	–	2,979.7	2,640.6	6.8	2,647.4
	80,316.5	**–**	**80,316.5**	68,155.6	6.8	68,162.4
Government and other securities						
Government	7,766.3	5,569.7	13,336.0	3,853.5	4,978.4	8,831.9
Financial institutions	16,629.7	876.4	17,506.1	15,508.2	1,221.8	16,730.0
Other (including public sector securities)	7,934.2	1,003.3	8,937.5	6,584.3	1,336.9	7,921.2
	32,330.2	**7,449.4**	**39,779.6**	25,946.0	7,537.1	33,483.1
Total currency banking and investment assets	**157,025.6**	**8,412.2**	**165,437.8**	144,952.0	8,769.4	153,721.4
Comprising:						
Cash equivalents	**2,979.7**	**–**	**2,979.7**	2,640.6	6.8	2,647.4
Other currency banking and investment assets	**154,045.9**	**8,412.2**	**162,458.1**	142,311.4	8,762.6	151,074.0

B. Currency investment assets

The Bank's investment assets are included in the balance sheet at market value. The excess of this value over the historical cost value is included in the securities revaluation account (reported under the balance sheet heading "Other equity accounts"), and realised gains or losses on the disposal of investment assets are recognised in the profit and loss account.

Note 20 provides further analysis of the securities revaluation account. Note 28 provides further analysis of net gains on sales of investment securities.

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

SDR millions	**2005**	2004
Balance at 1 April	8,769.4	7,494.8
Change in cash equivalents	(6.8)	(3.7)
Net change in currency investment assets		
Additions	14,133.8	16,725.0
Disposals	(3,384.2)	(5,263.7)
Maturities and other net movements	(10,956.8)	(10,240.7)
	(207.2)	1,220.6
Net change in transactions awaiting settlement	(63.9)	62.0
Market value and other movements	(79.3)	(4.3)
Balance at 31 March	**8,412.2**	8,769.4

7. 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.

Foreign 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 foreign currency, a bond or gold at a predetermined price. In consideration, the seller receives a premium from the purchaser.

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 market value of derivative financial instruments:

	2005			2004		
	Notional amounts	Market values		Notional amounts	Market values	
SDR millions		Assets	Liabilities		Assets	Liabilities
Bond futures	721.1	1.0	(1.2)	212.7	–	–
Bond options	82.7	0.7	–	388.4	0.1	–
Cross-currency interest rate swaps	10,619.0	246.7	(2,221.7)	11,388.0	241.4	(2,454.5)
Currency and gold forwards	1,297.6	16.0	(9.0)	2,209.5	17.7	(5.6)
Currency options	2,276.2	0.7	(4.4)	16.6	–	–
Currency and gold swaps	31,993.1	480.6	(145.3)	37,990.0	53.7	(750.1)
Forward rate agreements	45,074.2	5.3	(3.2)	17,623.0	4.7	(5.0)
Interest rate futures	19,195.0	1.4	(0.2)	42,143.9	0.4	(0.4)
Interest rate swaps	202,919.6	1,433.8	(1,038.5)	85,894.0	3,003.1	(1,099.1)
Options on futures	3,306.0	0.9	(0.5)	–	–	–
Swaptions	2,818.0	0.9	(16.6)	1,589.4	–	(25.0)
Total derivative financial instruments at 31 March	**320,302.5**	**2,188.0**	**(3,440.6)**	199,455.5	3,321.1	(4,339.7)
Net derivative financial instruments at 31 March			**(1,252.6)**			(1,018.6)

8. Accounts receivable

SDR millions	**2005**	2004
Financial transactions awaiting settlement	4,018.1	1,598.0
Other assets	10.5	11.6
Total accounts receivable	**4,028.6**	1,609.6

"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.

9. Land, buildings and equipment

SDR millions	Land	Buildings	IT and Other equipment	2005 Total	2004 Total
Historical cost					
Balance at 1 April	**41.2**	**185.1**	**88.1**	**314.4**	305.7
Capital expenditure	–	–	14.9	14.9	10.5
Disposals and retirements	–	–	(16.8)	(16.8)	(1.8)
Balance at 31 March	**41.2**	**185.1**	**86.2**	**312.5**	314.4
Depreciation					
Accumulated depreciation at 1 April	–	**68.3**	**56.1**	**124.4**	109.3
Depreciation	–	4.2	11.5	15.7	16.9
Disposals and retirements	–	–	(16.8)	(16.8)	(1.8)
Balance at 31 March	**–**	**72.5**	**50.8**	**123.3**	124.4
Net book value at 31 March	**41.2**	**112.6**	**35.4**	**189.2**	190.0

The depreciation charge for the financial year ended 31 March 2005 includes an additional charge of SDR 2.4 million following an impairment review (2004: SDR 3.3 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.

10. Currency deposits

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

SDR millions	**2005**	2004
Deposit instruments repayable at one to two days' notice		
Medium-Term Instruments (MTIs)	42,694.7	41,198.8
FIXBIS	53,712.0	35,212.5
	96,406.7	76,411.3
Other currency deposits		
Other deposit instruments (FRIBIS)	3,192.4	6,200.2
Sight and notice accounts and fixed-term deposits	51,019.7	50,541.0
	54,212.1	56,741.2
Total currency deposits	**150,618.8**	133,152.5

The Bank has undertaken to repay at market value certain deposit instruments, in whole or in part, at one to two business days' notice. The resulting gains or losses are included under the profit and loss account heading "Net valuation movement".

Currency deposits (other than sight and notice accounts) are included in the balance sheet at market 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 2005, is SDR 151,115.9 million (2004: SDR 131,482.6 million).

The Bank uses financial models to estimate the market 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 2005, changes to the assumptions about spreads used for valuing currency deposits decreased the Bank's profit by SDR 7.9 million.

11. Gold deposit liabilities

Gold deposits placed with the Bank originate entirely from central banks.

12. 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 the securities. They originate entirely from commercial banks.

13. 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.

14. Other liabilities

SDR millions	**2005**	2004
Retirement benefit obligations – see note 21		
Directors' pensions	4.2	4.0
Health and accident benefits	127.3	111.2
Payable to former shareholders	3.9	14.5
Other	15.9	14.7
Total other liabilities	**151.3**	144.4

15. Share capital

The Bank's share capital consists of:

SDR millions	**2005**	2004
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:

	2005	2004
Issued shares	547,125	547,125
Less: shares held in treasury	(36,933)	(77,052)
Outstanding shares eligible for dividend	**510,192**	470,073
Of which:		
Eligible for full dividend	470,073	452,073
Eligible for dividend pro rata from the value date of subscription	40,119	18,000
Dividend per share (in SDR)	**235**	225

The shares eligible for dividend pro rata from the value date of subscription reflect respectively the redistribution of shares held in treasury during the financial year ended 31 March 2005 (see note 18), and the issuance of shares to six new member central banks during the financial year ended 31 March 2004.

16. 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.

17. Repurchase 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. The compensation paid was CHF 16,000 per share. At the same time the Bank repurchased 2,304 shares of these three issues from other central banks. 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 (see note 18).

Three former private shareholders expressed dissatisfaction with the amount of compensation paid to them by the Bank in connection with the mandatory repurchase of shares and initiated proceedings with the Arbitral Tribunal in The Hague. These proceedings were completed with the final award of the Arbitral Tribunal on 19 September 2003, remitting an additional compensation of CHF 7,977.56 per share. The Bank applied the award to all former shareholders in final settlement of all claims with respect to the repurchased shares. The cost of repurchasing the total of 74,952 shares above was increased by SDR 153.8 million, as follows:

SDR millions	2004
Charged to shares held in treasury:	
Additional compensation in excess of provision	113.5
Charged to the profit and loss account:	
Additional interest thereon in excess of provision	32.9
Currency translation loss	7.4
Total	153.8

Former shareholders have returned the necessary documentation and claimed payment with respect to more than 99% of the repurchased shares. The compensation not yet paid is included in other liabilities (see note 14) and amounts to SDR 3.9 million (2004: SDR 14.5 million).

18. Shares held in treasury

	2005	2004
Balance at 1 April		
Repurchase of shares in the financial year ended 31 March 2001	74,952	74,952
Others	2,100	2,100
Total at 1 April	**77,052**	77,052
Redistribution to shareholding central banks	(40,119)	–
Balance at 31 March	**36,933**	77,052

In accordance with the Bank's Statutes, the BIS shares repurchased in early 2001 and subsequently held in treasury (see note 17) 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 to the central banks of those countries. The proceeds of this redistribution of 40,119 shares amounted to CHF 962.0 million, equivalent to SDR 536.7 million at the relevant transaction dates. This was credited to the Bank's equity accounts as follows:

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

The figure of SDR 456.4 million represents the SDR equivalent of the cost of the compensation in Swiss francs paid to the former private shareholders of the shares of the Belgian and French issues at the time of the shares repurchase in January 2001 and the final award of the Hague Arbitral Tribunal in September 2003. When the proceeds of redistribution of these shares were received during the year, an exchange gain of SDR 80.3 million was realised. This resulted from the appreciation of the Swiss franc against the SDR during the period from 2001 until these shares were sold.

The remaining shares held in treasury consist of 35,933 shares of the American issue (34,833 repurchased in 2001 and 1,100 previously held by the Bank) and the 1,000 suspended shares of the Albanian issue. Note 40 provides further information on the redistribution of the shares of the American issue.

19. Earnings per share

	2005	2004
Net profit for the financial year (SDR millions)	370.9	536.1
Weighted average number of shares entitled to dividend	486,673	462,114
Earnings per share – (SDR per share)	**762.1**	1,160

The dividend proposed for the financial year ended 31 March 2005 is SDR 235 per share (2004: SDR 225).

20. Other equity accounts

Other equity accounts represent the revaluation accounts of the currency and gold investment assets, which are further described in notes 5 and 6.

Other equity accounts comprise:

SDR millions	2005	2004
Securities revaluation account	92.2	178.5
Gold revaluation account	759.3	833.3
Total other equity accounts	**851.5**	1,011.8

A. Securities revaluation account

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

The movements in the securities revaluation account were as follows:

SDR millions	2005	2004
Balance at 1 April	178.5	337.2
Net valuation movement		
Net gain on sales	(7.0)	(154.4)
Market value and other movements	(79.3)	(4.3)
	(86.3)	(158.7)
Balance at 31 March	**92.2**	178.5

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

As at 31 March 2005 *SDR millions*	Market 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)**

As at 31 March 2004 *SDR millions*	Market value of assets	Historical cost	Securities revaluation account	Gross gains	Gross losses
Securities purchased under resale agreements	1,225.5	1,225.5	–	–	–
Time deposits and advances to banks	6.8	6.8	–	–	–
Government and other securities	7,537.1	7,358.6	178.5	193.0	(14.5)
Total	8,769.4	8,590.9	178.5	193.0	(14.5)

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 reporting 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:

SDR millions	**2005**	2004
Balance at 1 April	833.3	571.6
Net valuation movement		
Net gain on sales	(50.5)	–
Gold price movement	(23.5)	261.7
	(74.0)	261.7
Balance at 31 March	**759.3**	833.3

21. Retirement benefit obligations

A. Directors' pensions

The Bank operates an unfunded defined benefit arrangement for its directors, whose entitlement is based on a minimum service period of four years. The movement in the accounts during the year was as follows:

SDR millions	**2005**	2004
Liability at 1 April	4.0	4.0
Contributions paid	(0.3)	(0.3)
Charged to the profit and loss account	0.3	0.4
Exchange differences	0.2	(0.1)
Liability at 31 March – see note 14	**4.2**	4.0
Unrecognised actuarial loss	0.1	0.6
Present value of obligation	4.3	4.6

The actuarial assumptions used in calculating these benefits are comparable to those for staff pensions (see below), except that the estimated salary increase rate is assumed to be 1.5% per annum.

B. Staff pensions

The Bank operates a final salary defined benefit pension system for its staff. The pension system is based on a fund which is similar in nature to a trust fund, having no separate legal personality. Its assets are administered by the Bank for the sole benefit of current and former members of staff who participate in the arrangement. The fund is valued annually by independent actuaries. The latest actuarial valuation was carried out at 30 September 2004.

SDR millions	**2005**	2004
Present value of funded obligations	596.4	527.8
Market value of fund assets	(566.6)	(525.4)
	29.8	2.4
Unrecognised actuarial losses	(29.8)	(2.4)
Liability at 31 March	**–**	–

The movement in the accounts during the year was as follows:

SDR millions	**2005**	2004
Liability at 1 April	–	–
Contributions paid	(15.1)	(14.5)
Charged to the profit and loss account	15.1	14.5
Liability at 31 March	**–**	–

Amounts recognised in the profit and loss account were as follows:

SDR millions	**2005**	2004
Current service cost	23.3	20.0
Interest cost	18.9	17.4
Expected return on fund assets	(27.3)	(22.9)
Net actuarial losses recognised in year	–	2.9
Unrecognised actuarial loss / (gain)	0.2	(2.9)
Total included in operating expense	**15.1**	14.5

The principal actuarial assumptions used in the calculations above were as follows:

	2005	2004
Discount rate – market rate of highly rated Swiss corporate bonds	3.25%	3.5%
Expected return on fund assets	5.0%	5.0%

The actual return on fund assets in 2005 was 3.2% (2004: 13.9%). The obligation by the Bank towards its employees is the present value of promised retirement benefits. This obligation is calculated taking into account the salaries projected to the date at which benefits are payable for current employees. This salary increase rate is currently assumed to be 4.1% (2004: 4.1%). Furthermore, it incorporates estimated future increases in pensions payable of 1.5% (2004: 1.5%) for current and future pension system participants.

C. Health and accident benefits

The Bank also provides unfunded post-retirement health care and accident benefits, based on a minimum service period of 10 years. The methodology used for the determination of the costs and obligations arising from this arrangement and the actuarial assumptions used in calculating these benefits are comparable to those for staff pensions, except that there is an additional assumption for long-term medical inflation of 5% per annum.

The movement in the accounts during the year was as follows:

SDR millions	**2005**	2004
Liability at 1 April	111.2	97.1
Contributions paid	(1.7)	(1.2)
Charged to the profit and loss account	12.7	16.4
Exchange differences	5.1	(1.1)
Liability at 31 March – see note 14	**127.3**	111.2
Unrecognised actuarial loss	52.5	18.1
Present value of obligation	179.8	129.3

Amounts recognised in the profit and loss account were as follows:

SDR millions	**2005**	2004
Current service cost	7.7	7.0
Interest cost	4.7	4.1
Net actuarial losses recognised in year	0.3	0.4
Additional expense	–	4.9
Total included in operating expense	**12.7**	16.4

22. Interest income

SDR millions	**2005**	2004
Interest on investment assets		
Securities purchased under resale agreements	14.5	9.9
Government and other securities	255.4	269.8
Gold investment assets	23.4	25.4
	293.3	305.1
Interest on banking assets		
Treasury bills	335.5	233.4
Securities purchased under resale agreements	81.6	104.3
Time deposits and advances to banks	1,693.4	1,098.5
Government and other securities	767.5	721.6
Gold banking assets	7.2	8.2
	2,885.2	2,166.0
Interest on derivative financial instruments	**879.5**	1,022.3
Other interest	**0.8**	0.5
Total interest income	**4,058.8**	3,493.9
Of which: Interest received during the financial year	3,981.1	3,830.2

23. Interest expense

SDR millions	**2005**	2004
Interest on gold deposits	5.8	7.0
Interest on currency deposits	3,364.2	2,665.7
Interest on securities sold under repurchase agreements	14.1	8.4
Total interest expense	**3,384.1**	2,681.1
Of which: Interest paid during the financial year	3,320.7	2,676.6

24. Net valuation movement

SDR millions	2005	2004
Unrealised valuation movements on banking financial assets	(247.9)	(98.9)
Realised gains on banking financial assets	20.9	32.1
Unrealised valuation movements on financial liabilities	1,478.0	583.8
Realised losses on financial liabilities	(16.7)	(327.1)
Valuation movements on derivative financial instruments	(1,417.4)	(448.6)
Net valuation movement	**(183.1)**	(258.7)

25. Net fees and commissions income

SDR millions	2005	2004
Fees and commissions income	4.3	5.8
Fees and commissions expense	(3.0)	(4.4)
Net fees and commissions income	**1.3**	1.4

26. Net foreign exchange loss / gain

SDR millions	2005	2004
Net transaction gain	11.9	25.8
Net translation loss	(46.4)	(16.8)
Net foreign exchange (loss) / gain	**(34.5)**	9.0

The net translation loss in the financial year ended 31 March 2005 is attributable principally to the impact of the appreciation of the Swiss franc against the SDR on the Bank's short Swiss franc position (see note 37F) 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 18).

27. Operating expense

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

CHF millions	2005	2004
Board of Directors		
Directors' fees	1.6	1.6
Pensions	0.6	0.6
Travel, external Board meetings and other costs	1.0	1.5
	3.2	3.7
Management and staff		
Remuneration	97.1	96.1
Pensions	30.9	30.2
Other personnel-related expense	38.3	44.4
	166.3	170.7
Office and other expense	**64.5**	62.1
Administrative expense in CHF millions	**234.0**	236.5
Administrative expense in SDR millions	129.3	125.6
Depreciation in SDR millions	15.7	16.9
Operating expense in SDR millions	**145.0**	142.5

The average number of full-time equivalent employees during the financial year ended 31 March 2005 was 526 (2004: 509).

28. Net gain on sales of investment securities

SDR millions	2005	2004
Disposal proceeds	3,384.2	5,263.7
Amortised cost	(3,377.2)	(5,109.3)
Net gains	**7.0**	154.4
Comprising:		
Gross realised gains	32.9	172.5
Gross realised losses	(25.9)	(18.1)

29. Net gain on sales of gold investment assets

The profits on the sales of gold investment assets for the financial year ended 31 March 2005 were as follows:

SDR millions	**2005**
Disposal proceeds	108.6
Deemed cost – see note 20B	(58.1)
Gross realised gains	**50.5**

There were no disposals of gold investment assets during the financial year ended 31 March 2004.

30. Cash and cash equivalents

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

SDR millions	**2005**	2004
Cash and sight accounts with banks	25.8	18.9
Call / notice accounts	2,979.7	2,647.4
Total cash and cash equivalents	**3,005.5**	2,666.3

31. Taxes

The Bank's legal status in Switzerland is set out 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.

32. 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 financial year ended	
	2005	2004	**2005**	2004
USD	0.661	0.675	0.671	0.700
EUR	0.859	0.827	0.845	0.821
JPY	0.00619	0.00649	0.00625	0.00620
GBP	1.248	1.239	1.238	1.183
CHF	0.554	0.530	0.549	0.531
Gold	282.7	286.5	277.9	263.8

33. 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:

SDR millions	**2005**	2004
Nominal value of securities held under:		
Safe custody arrangements	10,009.2	9,153.5
Collateral pledge agreements	2,275.2	2,346.2
Portfolio management mandates	3,769.4	2,903.3
Total	**16,053.8**	14,403.0

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

34. Commitments

The Bank provides a number of committed standby facilities for its central bank and international institution customers. As at 31 March 2005 the outstanding commitments to extend credit under these committed standby facilities were SDR 5,480.4 million (2004:SDR 3,677.3 million), of which SDR 315.0 million was uncollateralised (2004: SDR 118.2 million).

35. 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 table below summarises the effective interest rate by major currencies for applicable financial instruments:

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	–	–	–	–

36. Concentration analysis

A. Total liabilities

SDR millions	**2005**	2004
Africa	14,024.8	9,771.6
Asia-Pacific	80,642.4	70,611.0
Europe	41,772.5	47,577.3
North and South America	28,910.3	25,287.6
International organisations	4,883.1	5,077.3
Total	**170,233.1**	158,324.8

The Bank's currency and gold deposits, principally from central banks and international institutions, comprise 92.7% of its total liabilities. At 31 March 2005 currency and gold deposits originated from 159 depositors (2004: 155). Within these deposits there are significant individual customer concentrations, with three customers each contributing in excess of 5% of the total on a settlement date basis (2004: five customers). Note 37 provides details of how the Bank manages the concentration risk in its funding base.

B. Credit commitments

SDR millions	**2005**	2004
Asia-Pacific	5,259.1	3,461.3
Europe	221.3	216.0
Total	**5,480.4**	3,677.3

Note 34 provides further analysis of the Bank's credit commitments.

C. Off-balance sheet items

SDR millions	**2005**	2004
Africa	594.6	527.4
Asia-Pacific	12,144.1	10,552.9
Europe	556.8	534.0
North and South America	2,758.3	2,788.7
Total	**16,053.8**	14,403.0

Note 33 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.

37. 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. Assets and liabilities are organised into two books:

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.

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 benchmark of bonds with a fixed duration target. The remainder of the Bank's equity is held in gold.

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, 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.

The Deputy General Manager is responsible for the Bank's risk control, compliance and internal audit functions. The head of compliance and head of internal audit also report to the Audit Committee of the Board of Directors.

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 the economic capital usage. 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 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 2005:

SDR millions	**2005**	2004
Share capital	683.9	683.9
Statutory reserves	8,743.2	8,230.8
Less: shares held in treasury	(396.2)	(852.6)
Tier 1 capital	**9,030.9**	8,062.1
Profit and loss account	370.9	536.1
Other equity accounts	851.5	1,011.8
Total capital	**10,253.3**	9,610.0

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 35.8% as at 31 March 2005 (2004: 34.7%).

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 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.

The Bank's credit policies ensure that the vast majority of its assets are invested with 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:

Sector of risk *Percentages*	**2005**	2004
Sovereign	32.5	29.0
Financial institution	61.7	65.0
Other	5.8	6.0
	100.0	100.0

BIS internal credit grade (expressed as equivalent long-term rating) *Percentages*	**2005**	2004
AAA	26.3	25.1
AA	57.0	54.9
A	16.1	19.6
BBB+ and below (including unrated risks)	0.6	0.4
	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 a combined basis across all components of market risk. Management limits the Bank's market risk economic capital usage.

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 market 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 180 tonnes (2004: 192 tonnes). This is held in custody or placed on deposit with commercial banks. At 31 March 2005 approximately 16% of its equity comprised gold holdings (31 March 2004: 18%). 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 market 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	**2005**	2004
Swiss franc	(137.0)	(655.6)
US dollar	21.3	297.9
Euro	4.3	111.3
Japanese yen	36.7	130.9
Pound sterling	12.7	57.7
Swedish krona	58.1	54.3
Other currencies	3.9	3.5

The short Swiss franc position at 31 March 2005 is attributable principally to the Bank's retirement benefit obligations (see note 21). The short Swiss franc position at 31 March 2004 was attributable principally to the repurchase of BIS shares during 2001 (see note 17) and to a lesser extent to the Bank's retirement benefit obligations. The reduction in the short Swiss franc position during 2005 arose from the subscription (the price of which was fixed in Swiss francs) by the central banks of Belgium and France for the shares of their national issues which were formerly held in treasury.

3. Interest rate risk

Interest rate risk is the potential impact on the market 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 benchmark of bonds with a fixed duration target. 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 market values to movements in interest rates. Market risk is restricted using economic capital, VaR and stress test-based limits.

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

As at 31 March 2005

SDR millions	Up to 6 months	7 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 market 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 2005

SDR millions	Up to 1 month	1 to 3 months	4 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**

As at 31 March 2004

SDR millions	Up to 1 month	1 to 3 months	4 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	18.9	–	–	–	–	–	–	–	18.9
Gold and gold deposits	5,711.4	315.8	603.0	514.2	532.2	1,397.2	–	–	9,073.8
Treasury bills	5,903.4	15,450.9	6,615.6	908.9	1,361.9	–	–	–	30,240.7
Securities purchased under resale agreements	21,771.1	64.1	–	–	–	–	–	–	21,835.2
Time deposits and advances to banks	31,589.7	16,640.8	15,138.2	3,814.4	979.3	–	–	–	68,162.4
Government and other securities	1,785.5	2,948.1	3,085.9	2,164.1	1,533.6	17,661.3	4,304.6	–	33,483.1
Accounts receivable	1,602.2	–	–	–	–	3.9	–	3.5	1,609.6
Land, buildings and equipment	–	–	–	–	–	–	–	190.0	190.0
Total	**68,382.2**	**35,419.7**	**25,442.7**	**7,401.6**	**4,407.0**	**19,062.4**	**4,304.6**	**193.5**	**164,613.7**
Liabilities									
Currency deposits									
Deposit instruments repayable at 1–2 days' notice	(4,798.2)	(12,072.9)	(14,572.6)	(5,828.5)	(4,015.2)	(31,727.3)	(3,396.6)	–	(76,411.3)
Other currency deposits	(42,269.9)	(7,438.1)	(6,374.4)	(560.3)	(98.3)	(0.2)	–	–	(56,741.2)
Gold deposits	(5,625.0)	(250.5)	(510.1)	(347.5)	(291.7)	(268.7)	–	–	(7,293.5)
Securities sold under repurchase agreements	(1,161.2)	(64.1)	–	–	–	–	–	–	(1,225.3)
Accounts payable	(12,169.4)	–	–	–	–	–	–	–	(12,169.4)
Other liabilities	(26.6)	–	–	–	–	–	–	(117.8)	(144.4)
Total	**(66,050.3)**	**(19,825.6)**	**(21,457.1)**	**(6,736.3)**	**(4,405.2)**	**(31,996.2)**	**(3,396.6)**	**(117.8)**	**(153,985.1)**
Net derivative financial instruments	(102.9)	(485.8)	(144.6)	3.2	(100.4)	(109.8)	(78.3)	–	(1,018.6)
Maturity gap	**2,229.0**	**15,108.3**	**3,841.0**	**668.5**	**(98.6)**	**(13,043.6)**	**829.7**	**75.7**	**9,610.0**

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:

- People (eg insufficient personnel, lack of requisite knowledge, inadequate training, inadequate supervision, loss of key personnel, inadequate succession planning and 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 outcomes of the CSA processes will be used to refine the quantification of operational risk at the Bank.

38. 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 plans; 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 this Annual Report entitled "Board of Directors and senior officials". Note 21 provides details of the Bank's post-employment benefit plans.

A. Related party individuals

The Bank offers personal deposit accounts for all staff members and its Directors. These accounts bear interest at a rate determined by the Bank's President. At 31 March 2005, the total balance on these accounts relating to members of the Board of Directors and Senior Officials of the Bank amounted to SDR 8.1 million (2004: SDR 7.4 million). Details of the Bank's remuneration policy are provided in the section of this Annual Report entitled "The Bank's administration".

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

SDR millions	**2005**	2004
Balance at 1 April	34,030.3	33,475.3
Deposits taken	104,844.2	101,407.8
Maturities, repayments and market value movements	(101,906.6)	(103,202.0)
Net movement on call / notice accounts	2,839.0	2,349.2
Balance at 31 March	**39,806.9**	34,030.3
Percentage of total currency deposits at 31 March	26.4%	25.6%

Gold deposits from related party central banks and connected institutions

SDR millions	**2005**	2004
Balance at 1 April	5,049.1	4,208.8
Deposits taken	154.3	224.5
Net withdrawals and gold price movements	(394.8)	615.8
Balance at 31 March	**4,808.6**	5,049.1
Percentage of total gold deposits at 31 March	67.6%	69.2%

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

SDR millions	**2005**	2004
Balance at 1 April	4,448.0	218.5
Deposits taken	1,200,762.4	294,192.5
Maturities and market value movements	(1,200,293.1)	(289,963.0)
Balance at 31 March	**4,917.3**	4,448.0
Percentage of total securities purchased under resale agreements at 31 March	35.0%	20.4%

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 7.4 million as at 31 March 2005 (2004: SDR 10.4 million). Gold held in sight accounts with related party central banks and connected institutions totalled SDR 5,170.3 million as at 31 March 2005 (2004: SDR 5,463.9 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 2005 was SDR 4,184.5 million (2004: SDR 2,846.4 million).

39. 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 17).

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 has 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 has 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 litigation or arbitration procedure involving the BIS is currently under way.

40. Subsequent event

On 10 January 2005, the Board of Directors decided to offer for sale to shareholder central banks the 35,933 shares of the American issue held in treasury by the Bank at the price of CHF 23,977.56 per share (see note 18). The closing date for responses to this offer was 15 April 2005, by which date bids had been received from shareholding central banks to purchase all 35,933 shares of the American issue held in treasury. The sale of these shares will be completed on 31 May 2005, and the Bank's equity will be increased by CHF 861.6 million (equivalent to SDR 477.5 million at the exchange rate on 31 March 2005).

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 188 to 215) 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.

Our audit included examining, on a test basis, evidence supporting the amounts in the balance sheet and profit and loss account and related disclosures. 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 2005 and the results of its operations for the year then ended so as to comply with the Statutes of the Bank.

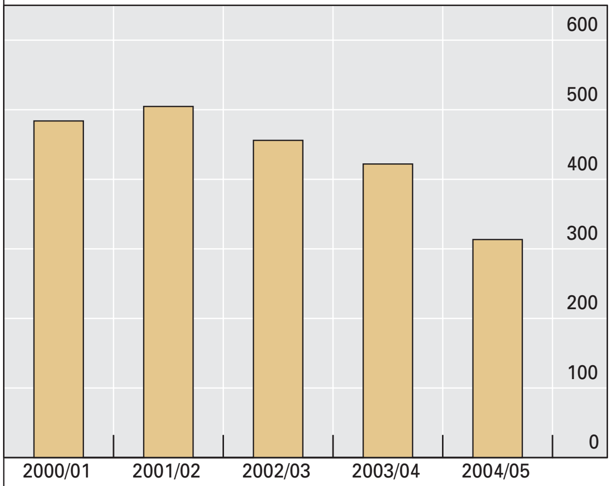
PricewaterhouseCoopers AG

Anthony W Travis | Albert Schönenberger

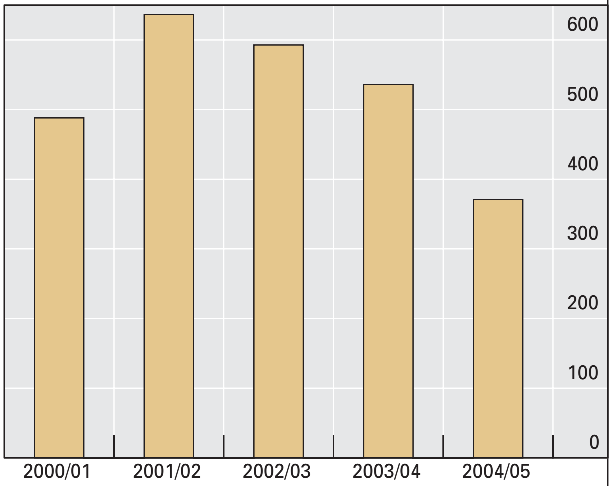
Basel, 9 May 2005

Five-year graphical summary

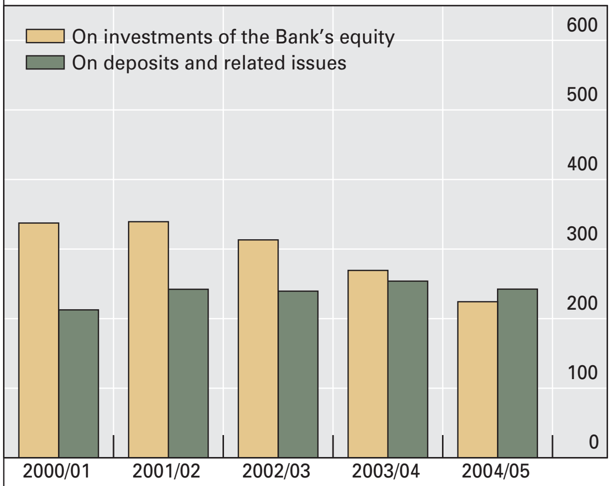
Operating profit
SDR millions



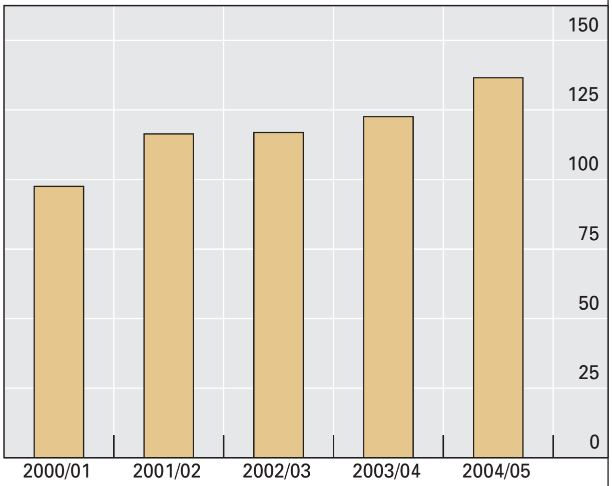
Net profit
SDR millions



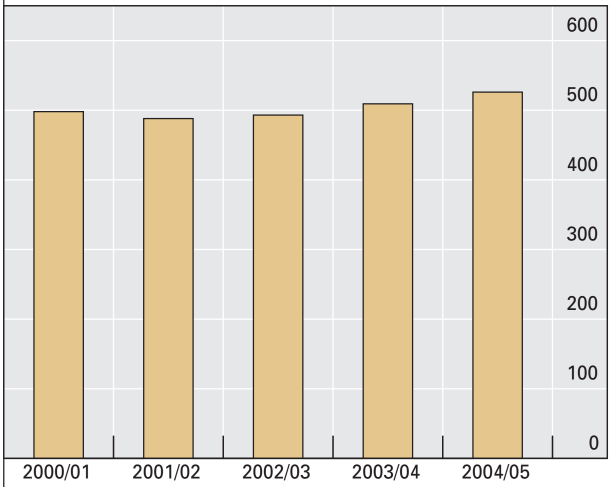
Net interest earned on currency investments
SDR millions



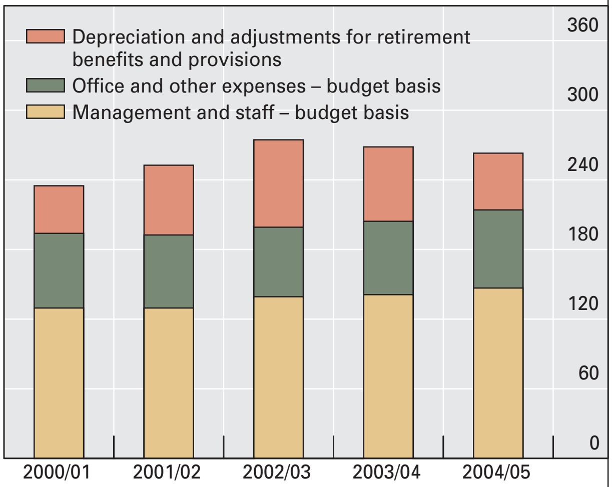
Average currency deposits (value date accruals basis)
SDR billions



Average number of employees
Full-time equivalent



Operating expense
CHF millions



Note: The financial information for the years prior to 2002/03 is based on best estimates.

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