

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**ANNUAL REPORT OF THE CHAIRPERSON OF THE
BUDGET AND FINANCIAL POLICIES COMMITTEE
1 JULY 2014 – 30 JUNE 2015**

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**Annual Report of the Chairperson of the
Budget and Financial Policies Committee
1 July 2014 – 30 June 2015**

The Budget and Financial Policies Committee (BUFIPOL) met on 35 occasions between July 1 2014 and June 30 2015, of which 8 were informal meetings. The Committee held joint meetings especially with the Audit Committee, namely 17 times, and one time each with the Policy and Evaluation Committee, the Organization, Human Resources and Board Matters Committee, and the Audit Committee. There were 11 Chair reports prepared submitting recommendations to the Board of Executive Directors.

The work of the Committee on recurring issues focused on the approval of the Bank's Administrative Budget, the discussion of the long term financial plans for the Ordinary Capital and the Fund for Special Operations, the approval of loan charges for sovereign guaranteed operations, the approval of the Bank's borrowing program, the approval of the contribution to the Bank's pension plans, and the quarterly discussion of the Ordinary Capital financial risk.

The reform of the capital adequacy framework, jointly with the Audit Committee, resulted in the approval of the Capital Adequacy Policy Mandate and Regulations by the Board of Governors. The review of the Bank's liquidity policy concluded with the approval of an updated policy. Finally, the work on updating the Income Management Model to make effective the new Capital Adequacy Policy will continue under the next Chairperson, and will conclude the reform of the Bank's main financial policies.

Lastly, the amendment of the Framework Agreement with the European Union, and the Proposal for the Establishment of the Korea Infrastructure Development Cofinancing Facility for Latin America and the Caribbean were approved.

Financial Programming, 2015 Administrative Budget, and 2014 Budget Execution

Financial Programming and the 2015 Administrative Budget

BUFIPOL held 5 sessions from 14 November to 4 December to consider Management's 2105 Program and Budget set forth in document GA-258-3. The Committee had previously discussed Management's 2015 Program and Budget Outlook Paper (GA-258-1), and recommended approval to the Board of the 2015-2016 Medium Term Capital Budget Plan (document GA-258).

The budget discussion began with a review of the Bank's long-term financial projections (FN-692-1) and a strategic overview of the program and budget proposal, followed by a series of presentations of the Bank's main organizational units. A wrap up session was held to conclude the discussions and finalize the Committee's recommendations to the Board. Approval of loan charges as in previous years was deferred until the end of the process. The Committee submitted to the Board the following recommendations: (i) accept Management's proposed lending spread of 85 basis points and a credit fee of 25 basis points, (ii) approve an

Administrative Budget with a real increase of 0% (3.3% nominal), (iii) total financing for Ordinary Capital Special Programs/Grants of US\$100 million, (iv) and a budget of US\$59.3 million for capital improvements.

Furthermore, a joint meeting was held with the Organization, Human Resources, and Board Matters Committee to discuss the Independent Consultation and Investigation Mechanism Proposed 2015 Work Program and Budget (document MI-45). Similarly, a joint meeting was held with the Policy and Evaluation Committee to discuss the Office of Evaluation and Oversight's Proposed 2015-2016 Work Program and Budget (document RE-479). Finally, a joint meeting was also held with the Audit Committee to discuss the 2015 Risk Based Audit Plan (document GN-2793).

Lastly as a result of the 2015 budget discussions the Committee held five meetings to discuss the following topics:

- (1) IDB Composite Price Adjustment Factor (CPAF) Methodology (GA-258-10). For this presentation, the Department of Research and Chief Economist (RES) explained that the methodology for calculating the CPAF follows that of traditional economic price indices.
- (2) Cost Savings and Cost Avoidance Measures (GA-258-13).
- (3) Study on Changes in the Bank's Activity and Production Functions following the Ninth Capital Increase. Final report. (GA-258-14). The Committee considered the Study on changes in the Bank's activity and production functions following the Ninth Capital Increase (document GA-258-14), prepared by external consultants Fernando Grafe, Gabriel Oddone, Sebastián Ithurralde, and Alejandro Pérez. Management also presented some considerations on the challenges of measuring the Bank's productivity (document PP-588-18), a series of indicators of the Bank's efficiency compared with other international financial institutions, and institutional performance trends in the Results-Based Budgeting Framework (document PP-588-17).
- (4) Budget Approval Process (document GA-258-15). The Budget and Administrative Services Department (BDA) presented the current Board budget and salary increase approval process and its historic evolution, and explained the implications of the types of Chair votes on budget resolutions.
- (5) Inter-American Development Bank - Financial Ratios (document GA-258-12). Management highlighted three key messages for this presentation: (i) the Board of Executive Directors receives extensive information on the Bank's financial ratios through different reports (quarterly Financial Risk Reports, MD&A, and documents related to the Long-Term Financial Projections); (ii) caution should be exercised when comparing ratios against other institutions as each entity might calculate a ratio differently, or even the operation per se may be different and can lead to inaccuracies or misleading inferences; and (iii) the context is critical to interpret ratios. According to Management, the Bank is generally comfortable with the level and number of ratios published at present.

2014 Program and Budget Execution Report as of 31 December 2014

Management presented the 2014 program and budget execution report as of 31 December 2014 (document GA-257-13). The purpose of this document is to report to the Board on the execution of the 2014 program and budget (GA-257-11) approved on December 13, 2013.

Fund for Special Operations

Fund for Special Operations. 2015 Long-term Financial Plan (document FN-694)

Management presented the 2015 Long-term Financial Plan (LTFP) for the Fund for Special Operations (FSO) and Grant Facility (GRF). This document is the fourth in the series of annual documents that Management presents to the Board on the financial situation of the FSO and the GRF, and their capacity to meet the lending and grant programs during the GCI-9 period. This document is primarily for informational purposes, thus not requiring any decisions by the Board.

Financial Policies and Risk Management

Capital Adequacy Policy: The Mandate (FN-568-19). Joint with the Audit Committee.

The joint Committee held 2 informal meetings and 3 formal meetings to discuss the capital adequacy framework, it was agreed that the documents on the Capital Adequacy Policy Mandate and the Regulations Governing the Implementation of the Capital Adequacy Policy would be submitted to the Board of Governors separately. The Committee agreed to recommend to the Board to submit the proposal to the vote of the Board of Governors.

Regulations Governing the Implementation of the Capital Adequacy Policy (FN-568-25). Joint with the Audit Committee.

The joint Committee held 3 informal meetings and 3 formal meetings to discuss the Regulations of the Capital Adequacy Policy.

RMG provided detailed information about the treatment of the preferred creditor status, the level of undisbursed balance, and the calibration of total capital requirements for the Bank's risk metric. Management also laid out the possible options for the countercyclical capacity: (i) reserving some kind of capacity for countercyclical products as part of the CCR capital base requirements, including the CCL and the DSL; (ii) including a buffer capacity of US\$2 billion for the CCL and US\$6 billion for the DSL only until the end of 2015 and lowering this amount from 2016 on; or (iii) engaging in a more strategic discussion about the Bank's countercyclical products to decide exactly how much capital should be reserved. RMG also emphasized the need to have clarity on the buffers in order to define the possibility of transferring capital to the New Corporation.

RMG also requested the Committees' guidance with respect to the proposed delegation to the Board of Executive Directors to consider and approve subsequent amendments to the Regulations upon the first anniversary of its date of effectiveness. The Committees agreed to recommend that the Board of Executive Directors approve a revised version of the "Regulations Governing the Implementation of the Capital Adequacy Policy" separating the decision on the Regulations from the decision on the delegation of authority contained in Appendixes I and II. Upon the Board of Executive Director's agreement, the two resolutions will be submitted to the Board of Governors for approval via electronic vote.

The Board of Governors approved the proposed Capital Adequacy Policy Mandate and Regulations.

Proposal for a Revised Ordinary Capital Liquidity Policy (document FN-600-16).

The revised policy is intended to: (i) target the "Strong" funding and liquidity classification under the Standard and Poor's criteria, while taking into account international best practices, such as the application of haircuts to the investment portfolio, longer minimum coverage horizons and a broader definition of net cash requirements, and (ii) include a policy ceiling designed to allow sufficient funding flexibility to ensure that the Bank can take advantage of attractive funding opportunities throughout the year. The Committee agreed to recommend that the Board of Executive Directors approve the Proposal for a Revised Ordinary Capital Liquidity Policy.

Income Management Model.

Continuing the discussions on the Income Management Model (IMM), Management presented to the consideration of the Budget and Financial Policies Committee (BUFIPO) a document to validate the IMM conceptual design (audiovisual presentation PP-645-3). Management revised the anchor principles according to the comments made by the Committee in the previous BUFIPO meeting and provided quantitative information and scenario runs to validate the following concepts: (i) tail event definition; (ii) timeframe to adjust within the warning zone; and (iii) potential use of differentiated rules for different zones in the buffer.

Financial Risk Report on the Ordinary Capital – Second quarter 2014 FN-691-1, Third quarter 2014 FN-691-2, Fourth quarter 2014 FN-691-3, and First quarter 2015 FN-698. Jointly with the Audit Committee.

The Risk Management Office (RMG) presented its quarterly financial risk reports on the Ordinary Capital, which provides highlights of the financial risk exposures of the Bank.

Bank Funding Matters

Borrowing Program for 2015 (FN-696) and Report on 2014 Borrowing Program Results (FN-689-5).

The Committee agreed to recommend that the Board approve: (i) the Global Borrowing Authorization as set forth in Annex I of document FN-696 and the Global Liability Management

Authorization as set forth in Annex II of document FN-696, and (ii) authorize the US\$20 million negative net income impact ceiling for the Debt Repurchase Program as set forth in paragraph 2.6 of the same document.

2014 Bank Contributions to the Bank's Retirement Plans GN-2599-36.

The Committee agreed to recommend Board approval of the contributions proposed.

Funds

Proposal for the Establishment of the Korea Infrastructure Development Cofinancing Facility for Latin America and the Caribbean (document GN-2804).

The proposed US\$100 Million contribution by the Republic of Korea will be used to co-finance IDB Sovereign Guaranteed loans. A Committee Chairperson report was prepared recommending that the Board approve the Resolution attached to the "Proposal for the establishment of the Korea Infrastructure Development Co-financing Facility for Latin America and the Caribbean".

Proposal for the Amendment and Restatement of the Framework Agreement between the European Commission and the Inter-American Development Bank GN-2605-2.

The Committee agreed to recommend that the Board of Executive Directors approve Management's recommendations to amend and restate the Framework Agreement between the European Commission and the Inter-American Development Bank (document GN-2605-2), signed on 19 July 2011.

Conclusion

I would like to acknowledge the leadership of Director Echeverry, he Chaired BUFIPO through the end of 2014, and guided in that capacity to a successful conclusion the discussions of the Bank's Administrative Budget as well as the significant review of the Bank's Adequacy Policy Mandate and Regulations. The review of the Income Management Model to make effective the Capital Adequacy Policy approved by the Board of Governors is the last piece remaining of the reform of the Bank's financial policies. Discussion of this issue has started, and its conclusion will be a key task for my successor.

Measurement of the Bank's productivity, which has been of keen interest to the Committee for some time, has made encouraging progress with the presentation of the external consultants' report. The challenge will be to build on the progress achieved so far complementing the standard reporting on Bank costs, with result based budgeting indicators as well as productivity measures that attempt to capture to the extent possible the quality of the Bank's services.

Lastly, I want to thank Pedro Auger for his excellent work as Secretary of the Committee, Carmen Comin for her highly efficient planning of the work program, and Oriana Bonfim, Margarita Orozco, and Ward Tanner who prepared detailed and very accurate minutes. I also want to acknowledge the excellent work of the interpretation and translation teams, who although invisible to the eyes of the Committee, perform irreplaceable work with high standards. I would also like to give a special thanks to the entire management team, Vice president Jaime Sujoy, Yeshi Edwin and his team, Gustavo de Rosa and Sikander Daryanani and their teams. We maintained a fluid and open dialogue and their highly professional work and commitment led to a productive engagement with the Committee under an ambitious work program. Lastly I want to thank my alternate Director, Cristina Penido, for her support during my term, and the members of the Committee, who greatly facilitated my task as Chairperson.