

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

**ANNUAL REPORT OF THE CHAIRPERSON OF THE
BUDGET AND FINANCIAL POLICIES COMMITTEE**

1 JULY 2016 TO 30 JUNE 2017

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**Annual Report of the Chairperson of the
Budget and Financial Policies Committee
1 July 2016 to 30 June 2017**

The Budget and Financial Policies Committee met on 40 occasions between 1 July 2016 and 30 June 2017. Nine of these were informal meetings and the remaining 31 were informal. The Committee held five formal joint meetings with the Audit Committee, as well as several others with the Policy and Evaluation Committee, the Programming Committee, and the Committee of the Board of Executive Directors of the IIC. Thirteen Committee Chairperson reports were prepared, presenting recommendations to the Board of Executive Directors.

The Committee's work on recurring issues focused on the approval of the Bank's administrative budget, lending charges for sovereign guaranteed operations, contributions to the Bank's retirement plans, as well as the consideration of the long-term financial projections of the Ordinary Capital and the quarterly discussions on the Ordinary Capital financial risk.

One of the most relevant emerging issues is the transfer of the resources of the Fund for Special Operation (FSO) to the Ordinary Capital. This will guarantee sustainable access to concessional loans for countries that meet the established criteria, which have been updated and spelled out to ensure that such lending is solely for technical assistance and the corresponding benefits to be obtained in terms of the Bank's capital indicators. Accordingly, a discussion of the Bank's countercyclical role was held jointly with the Policy and Evaluation Committee, and a proposal was approved for the use of the enhanced lending capacity within the institution's Income Management Model. The implementation of this set of measures aimed at strengthening the Bank's capital facilitated a decrease in the lending spread on the sovereign guaranteed portfolio from 115 basis points (bps) to 85 bps, and the credit fee remained at 50 bps.

Regarding the 2017 administrative budget, the Board of Executive Directors approved a nominal increase of 3.3% with respect to the budget approved for 2016, as part of a major effort to reduce the amount initially proposed by Management by US\$6 million.

**2017 Administrative Budget, Budget Execution, Financial Programming,
and Strategic Programs**

Financial programming and the 2017 administrative budget

Following the initial 29 September presentation on the 2017 Program and Budget Outlook Paper (document GA-263), the Committee held six meetings between 14 November and 5 December to consider the 2017 Administrative Budget Proposal (document GA-263-1). The Committee also reviewed the following programs and budgets: (1) the 2017 Risk-based Audit Plan (document GN-2871), jointly with the Audit Committee; (2) the Office of Evaluation and Oversight's (OVE) Proposed 2017-2018 Work Program and Budget (document RE-507-1), by streamlined procedure; and (3) the Independent Consultation and Investigation Mechanism's (MICI) Work Program and Budget (document MI-60), also by streamlined procedure. In parallel, the Committee discussed the Long-term Financial Projections of the Ordinary Capital – Final Document (document FN-706-3). As in previous years, the decisions on the administrative budget were made at the same time as the decision on the lending charges, affecting the entire sovereign guaranteed portfolio.

The Committee submitted the following proposals to the Board for approval: (i) Management's recommendation to set the lending spread at 85 bps and maintain the credit fee at 50 bps; (ii) a discretionary administrative budget with a nominal increase of 3.3%; (iii) a US\$100 million envelope

for Ordinary Capital Strategic Development Programs; and (iv) a US\$47.8 million improvement program. The administrative budget presented included a salary increase of 2.5% for international staff and 0% for national staff. The increase for national staff was implemented owing to exchange-rate differentials. The operating budget for Board of Executive Directors remained conservative, emphasizing greater efficiency and operational improvements, as well as the transfer of the protocol budget item from the Office of the Secretary (SEC) to the Board of Executive Directors (EXD). This item should not have been included in the discretionary expenditures of the administrative budget. Consequently, this action restored the governance function and autonomy of these resources to the Board's budget.

2017-2019 Medium-term Capital Budget Plan (GA-261-6)

Management requested that the Board of Executive Directors consider and approve the 2017-2019 Medium-term Capital Budget Plan (document GA-261-6). This plan falls under the Budget Process of the Inter-American Development Bank 2014 – Updated version (document GA-197-14), based on a more robust prioritization methodology. Management explained that adjustments were made to the list of projects in the previous plan (2016-2018), and new projects were included using the prioritization methodology introduced in 2013.

Management also clarified that the spending authorizations related to 2017 would be requested in October 2016 via a budget resolution in the 2017 Program and Budget Proposal. The 2018 and 2019 budget plans were provided for information and would be reviewed as part of the three-year rolling plan. The Board approved the 2017 capital budget plan as presented.

Cost Structure and Determinants of the Administrative Budget (GA-263-2) and Benchmarking Multilateral Development Bank (MDB) Resources for Oversight and Compliance (GA-263-3)

The Budget and Financial Policies Committee considered the documents Cost Structure and Determinants of the Administrative Budget (document GA-263-2) and Benchmarking Multilateral Development Bank (MDB) Resources for Oversight and Compliance (document GA-263-3).

The purpose of document GA-263-2 was to analyze the underlying cost structure of the administrative budget, presenting a complementary strategic perspective to the annual budget exercise. Specifically, it examined the cost structure associated with the Bank's cooperative business model, disaggregating costs and presenting coefficients at the country level. Document GA-263-3 analyzed the oversight and compliance functions, as well as internal conflict resolution mechanisms, benchmarking them with those of other MDBs.

An OVE Oversight Study: The Evolution of Administrative Spending in the Inter-American Development Bank (RE-499-1, RE-499-2). Joint meeting with the Policy and Evaluation Committee

In keeping with the strategy to present the best information possible on the Bank's budget, the Budget and Financial Policies Committee and the Policy and Evaluation Committee considered document RE-499-1, An OVE Oversight Study: The Evolution of Administrative Spending in the Inter-American Development Bank, and the respective Comments from Management (document RE-499-2). These documents will serve as the basis for future discussions on administrative spending.

The Committees took note of the OVE study and Management's comments.

Ordinary Capital Strategic Development Programs (GA-263-1)

Management presented the 2017 Allocation Proposal for the Ordinary Capital Strategic Development Programs. The Committee took note of the presentation, which considered increasing the allocation for such programs to US\$100 million.

Long-term Financial Projections of the Ordinary Capital 2017 Preview Document. Revised version (FN-706-1)

The Committee considered the Long-term Financial Projections (LTFP) of the Ordinary Capital 2017 – Preview Document (document FN-706-1). Committee members expressed their agreement with Management's recommendation to maintain the lending charges for sovereign guaranteed operations at 115 bps during the second half of 2016, and to decrease them to 85 bps beginning 1 January 2017. A lively discussion ensued, resulting in an opportunity to provide Management with guidance in preparing the final LTFP document for 2017, which was considered in 2016. The Committee Chairperson presented a report to the Committee of the Whole with that meeting's conclusions.

2016 Program and Budget Execution Report as of 30 June 2016 (GA-261-10)

The Committee considered the 2016 Program and Budget Execution Report as of 30 June 2016, the purpose of which was to report to the Board of Executive Directors on the mid-year execution of the 2016 Program and Budget (document GA-261-4), approved on 16 December 2015 and amended on 23 June 2016. The full year report as of December was presented in the first quarter of 2017. The Committee took note of Management's report.

2016 Program and Budget Execution Report as of 31 December 2016 (GA-261-13)

Management presented the 2016 Program and Budget Execution Report as of 31 December 2016 (document GA-261-13). The purpose of this document was to report to the Board on the execution of the 2016 program and budget. The Committee took note of the report.

Fund for Special Operations and IDB Grant Facility

Proposal for Sustaining Concessional Assistance by Optimizing the IDB's Balance Sheets (GN-2846-4). Joint meeting with the Programming Committee

The Budget and Financial Policies Committee and the Programming Committee of the Board of Executive Directors considered the Proposal for Sustaining Concessional Assistance by Optimizing the IDB's Balance Sheets (document GN-2846-4). The proposal's main objective was to ensure and reinforce the Bank's capacity to continue providing concessional financing to the poorest and most vulnerable countries in the region. The document was based on a November 2015 technical briefing to the Board of Executive Directors, and on the consultation paper "Sustaining Concessional Assistance by Optimizing the IDB's Balance Sheets" (document AB-3066). It also benefited from the inputs provided by Governors during various subregional meetings in early 2016 and in the context of the Annual Meeting of the Governors of the IDB in Nassau, The Bahamas.

Following ample discussion, the Committees' review, and extensive consultations, it was resolved that a revised version of the document would be submitted to the Board of Executive Directors for

consideration, for the latter to recommend its approval by the Board of Governors by the procedure of taking a vote without calling a meeting.

Financial Policies and Financial Risk Management

Conceptual Framework. Continuing the Discussion on Financial Instruments and Countercyclical Role of the IDB (GN-2855-1). Joint meeting with the Policy and Evaluation Committee

Continuing the discussion on the review of the Bank's financial instruments and countercyclical role, Management presented the basic terminology adopted on this topic to the Policy and Evaluation Committee and the Budget and Financial Policies Committee, and explained the rationale for dividing this debate into two separate discussions: (i) the periodic review of financial products; and (ii) the Bank's countercyclical role. Management also presented a timeline for the consideration of topics, and proposed a change in the sequence of the discussion to prioritize the design and approval of a specific ex post product for the emergency lending category.

The Committee expressed agreement with Management's proposed discussion framework and asked it to revise the timeline proposed initially to reflect that the strategic discussion on the Bank's countercyclical role and consideration of an emergency lending instrument would be held in parallel.

Proposal for Determination of Availability and Use of the Enhanced Lending Capacity (GN-2855-3)

The Budget and Financial Policies Committee and the Policy and Evaluation Committee considered the Proposal for Determination of Availability and Use of the Enhanced Lending Capacity (document GN-2855-3 and audiovisual presentations PP-781 and PP-781-1). In that document, Management requested that a proposal to determine the availability of the Bank's countercyclical capacity and establish rules for its use be submitted to the Board of Executive Directors.

The Committees provided input and observations, and resolved that Management would prepare a revised version of the document (document GN-2855-5) for the Committees' consideration by the streamlined procedure. In the event that no additional comments were received from members of the Committees within the time frame established in the streamlined procedure, that fact would be reflected in the minutes of a forthcoming meeting of each of the Committees, and a report by their Chairpersons on the matter would be submitted to the Committee of the Whole.

Financial Risk Management: Asset/Liability Management for Transfer of FSO Assets and Liabilities (FN-644-7)

The Office of Risk Management presented the document "Financial Risk Management: Asset/Liability Management for Transfer of FSO Assets and Liabilities" (document FN-644-7). The Committee agreed to recommend that the Board of Executive Directors authorize the recommendation set out in document FN-644-7.

Proposal to Convert Bank's Convertible Currencies Subject to MOV (FN-653-5)

Management presented its Proposal to Convert Bank's Convertible Currencies Subject to MOV (maintenance of value) (document FN-653-5), proposing to convert and settle non-U.S. dollar

convertible currencies for which the Bank had a payable obligation with the member countries, and requesting authorization to convert all remaining convertible currencies, provided that exchange rate fluctuations would ensure that receivable MOV balances became small payments.

The Committee resolved to submit the Proposal to Convert Bank's Convertible Currencies Subject to MOV, with the changes noted (document FN-653-6), to the Committee of the Whole for consideration.

Proposed Amendments to the Cross-booking Framework between the Inter-American Development Bank and the Inter-American Investment Corporation (CII/GN-306-4, CII/PP-200, GN-2823-4). Regulations for Cross-booking between the IDB and the IIC (CII/GN-306-5, GN-2823-5). Cross Booking Process, Underwriting Guidelines, and Implementation. Supporting Document for Information (CII/GN-306-6, GN-2823-6)

Within the scope of action of the IDB and the IIC to streamline and manage the budget, the Budget and Financial Policies Committee of the IDB and the Committee of the Board of Executive Directors of the IIC considered the Proposed Amendments to the Cross-booking Framework between the Inter-American Development Bank and the Inter-American Investment Corporation (document CII/GN-306-4, GN-2823-4). Document GN-2823-8, with the changes noted in the meeting room, was submitted to the Committee of the Whole.

2016 Bank Contributions to Retirement Plans and Reaffirmation of Stable Contribution Rates per Long-term Funding Policy, and 2016 Corporation Contributions to Retirement Plans (GN-2599-45, CII/GN-333). Joint Meeting with the Committee of the Board of Executive Directors of the IIC

In keeping with the agreement reached the previous year and the commitment to facilitate the long-term sustainability of the IDB Group's retirement plans, Management presented its proposal for the contributions of the IDB and the IIC to the Group's five retirement plans: three defined benefit pension plans, i.e. the Staff (SRP), Local (LRP), and Complementary Staff (CSRP) Retirement Plans; the Postretirement Benefits Plan (PRBP); and the Retiree Life Insurance Program (RLIP).

The Committees agreed to recommend that the Boards of Executive Directors of the IDB and the IIC approve Management's proposal.

Financial Risk Reports on the Ordinary Capital – Second quarter 2016 (FN-705-1), Third quarter 2016 (FN-705-2), Fourth quarter 2016 (FN-705-3), and First quarter 2017 (FN-708). Joint meeting with the Audit Committee

The Office of Risk Management presented quarterly reports on the financial risk of the Ordinary Capital. These provided an overview of the Bank's financial risks. The Committees took note of the reports.

Borrowing Program

First Semester 2016 Borrowing Program (FN-702-2). First Semester 2016 Investment Results (FN-702-3)

The Committee considered and took note of the First Semester 2016 Borrowing Program (document FN-702-2) and the First Semester 2016 Investment Results (document FN-702-3).

Report on 2016 Borrowing Program Results (FN-702-4). Report on 2016 Investment Results (FN-702-5)

Management also presented the Report on 2016 Borrowing Program Results (document FN-702-4) and the Report on 2016 Investment Results (document FN-702-5). The Committee took note of both.

Facilities

Proposal for the Establishment of the Sustainable Colombia Facility (Multi-Donor Trust Fund) (GN-2865)

The Budget and Financial Policies Committee considered the Proposal for the Establishment of the Sustainable Colombia Facility (Multi-Donor Trust Fund) (document GN-2865). The facility's objective was to enable initiatives aimed at maximizing the environmental, economic, and social dividends of peace in Colombia, primarily in areas affected by armed conflict. The facility will address four main challenges: (i) deforestation and loss of natural capital; (ii) rural poverty and territorial development; (iii) low local capacity and lack of coordination; and (iv) climate change challenges.

The Committee recommend that the IDB Board of Directors approve the proposed resolution accompanying document GN-2865 that established the Sustainable Colombia Facility.

Proposal for the Establishment of the NDC Pipeline Accelerator Multi-Donor Trust Fund (GN-2890)

Management presented the Proposal for the Establishment of the Nationally Determined Contribution (NDC) Pipeline Accelerator Multi-Donor Trust Fund (document GN-2890 and audiovisual presentation PP-796). The NDC Pipeline Accelerator Multi Donor Trust Fund aims to: (i) support IDB Group member countries in preparing the necessary investments to meet their climate and sustainable development objectives; (ii) mobilize and provide resources to cover additional costs associated with planning, identifying, preparing, and managing sustainable projects; and (iii) accelerate these projects through the project cycle.

The Committee supported the recommendations set forth in section III of document GN-2890. A chairperson report was prepared recommending that the Board of Executive Directors approve the Proposal for the Establishment of the NDC Pipeline Accelerator Multi-Donor Trust Fund.

Proposal for a Partnership to Channel Resources from the "Infrastructure Fund for Mesoamerican and Caribbean Countries" through the Bank (GN-2892)

The partnership's objective is to facilitate the IDB's participation in channeling resources from the Yucatán Fund as part of its efforts to further the development of Latin America and the Caribbean.

The IDB's participation will facilitate access to the fund's resources for Mesoamerican and Caribbean countries.

The Committee members firmly supported the proposal. They highlighted the innovative nature of the fund's enhanced support and thanked the Mexican government for the initiative. The Executive Directors inquired about the fund's characteristics, especially the use of zero coupon bonds as security, the countries that were eligible to receive resources, and the instrument's dissemination throughout the target region.

The First Vice Chairperson of the Budget and Financial Policies Committee submitted his report to the Board of Executive Directors, recommending approval of the recommendations contained in paragraphs 4.1 and 4.2, as well as the resolution attached as Annex B of document GN-2892.

Regional Fund for Agricultural Technology (FONTAGRO). Proposal to Amend the Administration Agreement (GN-1965-14)

The Budget and Financial Policies Committee considered the proposal to amend FONTAGO's administration agreement (GN-1965-14). The Committee Chairperson prepared his report recommending that the Board of Executive Directors approve the proposal contained in section III of document GN-1965-14.

Conclusion

During my term as Committee Chairperson, which ended on 30 June 2017, the global economy showed weak signs of economic recovery against a backdrop of uncertainty that has affected commodity prices. There can be no doubt that this situation has had a major impact on the region. Under these complex circumstances, the Bank has played a key role in providing resources and knowledge to the region's countries.

As a venue for political dialogue, the Budget and Financial Policies Committee made headway in various activities. This fact is documented in its decisions aimed at strengthening the Bank's financial capacity, to enable it to continue addressing the region's challenges in a robust way, as it has done since its inception. One such example has been the important challenge of consolidating the FSO's resources into the Ordinary Capital, with the aim of ensuring the sustainability of concessional assistance through a structure of combined loans that could increase the "lifecycle" of these resources. These would support to the region's poorest and most vulnerable countries and may also have a favorable impact in terms of substantially increasing the capital base of the Ordinary Capital, with an immediate impact on strengthening the risk-adjusted capital (RAC) ratio and Stand-alone Credit Profile indicators. Another important milestone was the approval of the document on the Bank's countercyclical role.

In an effort to alleviate the financial pressure on the Bank's member countries, and thanks to aforementioned actions and decisions taken to strengthen the Bank's capital, a financial efficiency agreement was reached that, in the context of the LTFPs, made it possible to decrease lending charges to 85 bps.

The Committee also worked diligently for the approval of the 2017 Budget, which reflected a real increase of 1.2% (3.3% nominal). The 2017 Budget discussion was informed by OVE's "Evolution of Administrative Spending" study, as well as various meetings and documents that helped facilitate greater understanding and discussion of budget issues. In 2017, Management agreed to examine the following matters: (a) a multiyear framework for the administrative budget; (b) additional opportunities to increase the efficiency of expenditures; (c) updating the results-based budget framework; and (d) expanding the cost structure study, to include the investment, policy-based lending, and sector work dimensions.

With the support of the Board of Executive Directors, Management can continue its work on the efficient use of resources and identification of budget savings without compromising the quality of service the Bank provides to its member countries, especially amid a volatile financial environment entailing a variety of threats for the region.

It should be noted that the allocation for the Strategic Development Programs has once again reached the \$100 million level. The progress made on all these budget and finance issues has been solid and efficient in terms of the decisions made on and time invested in them, thanks to the support of my fellow Executive Directors, who worked hard to achieve greater benefits for the region and the Bank. I would like to take this opportunity to express my heartfelt thanks to them for their input and guidance, which has helped move the work program ahead during my year as Committee Chairperson.

It was a year of very intense work, and I would like to extend my very special thanks to the entire Management team; to Vice President Jaime Sujoy, Yeshe Edwin, Gustavo de Rosa, Federico Galizia, Sikander Daryanani, and all their teams. The high level of professionalism and commitment of all of them allowed for an open and productive dialogue with the Committee.

Lastly, I would like to thank Pedro Auger for his excellent work as Committee Secretary and the rest of the team of the Office of the Secretary who helped prepare the minutes and plan the work program. I would also like to extend special recognition to the translation and interpretation teams, whose work is essential for that of the Committee. I will close by thanking my work team, the Counselors and Assistants of the chairs, whose efforts facilitated the completion of the Committee's work program.