IDB

Annual Report **2011**

Financial Statements

Letter of Transmittal

As required by the By-Laws of the Inter-American Development Bank, the Board of Executive Directors hereby submits to the Board of Governors the Annual Report of the Bank for 2011. The Annual Report consists of a printed volume entitled "The Year in Review," containing a review of the Bank's operations in 2011 (loans, guarantees, and grants). The electronic version of the Annual Report at www.iadb.org/ar/2011 contains, in addition, the full set of the financial statements of the Bank's resources.

March 9, 2012

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FINANCIAL OVERVIEW

Unless otherwise indicated, all information provided in this Management's Discussion and Analysis refers to the Bank's Ordinary Capital.

The purpose of the Bank is to further the economic and social development of Latin America and the Caribbean by promoting environmentally sustainable growth, as well as poverty reduction and social equity. Alongside these objectives are two strategic goals: addressing the special needs of the less developed and smaller countries and fostering development through the private sector. The Bank is an international institution established in 1959, pursuant to the Agreement establishing the Inter-American Development Bank (the Agreement), and is owned by its member countries. These members include 26 borrowing member countries and 22 non-borrowing member countries. The five largest members by shareholdings (with their share of total voting power) are the United States (30.0%), Argentina (10.8%), Brazil (10.8%), Mexico (6.9%) and Venezuela (5.8%).

The resources of the Bank consist of the Ordinary Capital, the Fund for Special Operations (FSO), the Intermediate Financing Facility Account (IFF) and the IDB Grant Facility (GRF).

The financial strength of the Bank is based on the support it receives from its members and on its financial policies and practices. Member support is reflected in the capital backing received and in the diligence with which borrowing members meet their debt-service obligations. Prudent financial policies and practices have led the Bank to build its retained earnings, diversify its funding sources, hold a large portfolio of liquid investments and limit a variety of risks, including credit, market and liquidity risks. The objective of the Bank is to earn an adequate level of income to preserve its financial strength and sustain its development activities. **Box 1** presents selected financial data for the last five years.

The principal assets are loans to member countries. As of December 31, 2011, 95% of loans outstanding were sovereign-guaranteed. In addition, under certain conditions and subject to certain limits, the Bank makes loans and guarantees without a sovereign guarantee (i) in all economic sectors, and (ii) directly to private sector or sub-national entities carrying out projects in borrowing member countries. The Bank can also lend to other development institutions without sovereign guarantee. Non-sovereign-guaranteed operations are currently capped to an amount such that risk capital requirements for such operations do not exceed 20 percent of Total Equity[1] calculated in the context of the Bank's capital adequacy policy. As of September 30, 2011, the date of the latest quarterly report to the Board of Executive Directors, the risk capital requirements for non-sovereign-guaranteed operations was $1,091 million, or 5%[2] of Total Equity.

The Bank issues debt securities in a variety of currencies, formats, maturities and structures to investors worldwide. These borrowings, together with the Bank's equity, are used to fund lending and investment activities, as well as general operations.

Assets and liabilities, after swaps, are held primarily in United States dollars, but also in euro, Japanese yen and Swiss francs. The Bank minimizes exchange rate risk by matching the currencies of its liabilities with those of its assets and by maintaining basically all equity in United States dollars. However, the reported levels of assets, liabilities, income and expenses are affected by exchange rate movements between such major currencies and the reporting currency, the United States dollar.

Financial Statement Reporting

The financial statements are prepared in accordance with generally accepted accounting principles (GAAP). The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported results. See Additional Reporting and Disclosure section for some of the more significant accounting policies used to present the financial results in accordance with GAAP, which involve a relatively high degree of judgment and complexity and relate to matters that are inherently uncertain.

A substantial amount of the Bank's borrowings and all swaps, including borrowing, lending, and equity duration[3] swaps, are measured at fair value through income. The reported income volatility resulting from the non-trading financial instruments is not fully representative of the underlying economics of the transactions as the Bank holds these instruments to maturity. Accordingly, the Bank excludes the impact of the fair value adjustments associated with these financial instruments from the regular results of its operations. The Bank defines Income before Net fair value adjustments on non-trading portfolios and Board of Governors approved transfers[4] as "Operating Income". Net fair value adjustments on non-trading portfolios and Board of Governors approved transfers are reported separately in the Statement of Income and Retained Earnings.

Accounting Developments: As described in Note B to the financial statements, in 2011 the Financial Accounting Standards Board (FASB): (i) provided additional guidance to help creditors in determining whether a restructuring constitutes a troubled debt restructuring; (ii) issued converged fair value measurement guidance expanding certain disclosures about fair value measurements; and (iii) eliminated the current option to report other comprehensive income and its components in the statement of changes in equity, by requiring the presentation of items of net income and other comprehensive income in one continuous statement or in two separate but consecutive statements. These standards do not have a material effect on the Bank's financial statements.

The FASB also required disclosure of both gross information and net information about financial and derivative instruments eligible for offset in the statement of financial position and instruments and transactions subject to an agreement similar to a master netting arrangement, for annual reporting periods beginning on or after January 1, 2013 and interim periods within those annual periods. The Bank is in the process of evaluating the impact of this new standard on its financial statements.

(1) "Total Equity" is defined as Paid-in capital stock, Retained earnings and the allowances for loan and guarantee losses, minus borrowing countries' local currency cash balances, net receivable from members (but not net payable to members) and the cumulative effects of Net fair value adjustments on non-trading portfolios.

(2) For purposes of calculating the limit for non-sovereign-guaranteed operations, loans to the Inter-American Investment Corporation (IIC), a separate affiliated international organization part of the IADB Group, in the amount of $100 million are not included.

(3) In order to manage the sensitivity to changes in interest rates (duration or modified duration) of its equity, the Bank utilizes equity duration swaps to maintain the modified duration of its equity within a defined policy band of four to six years.

(4) References to captions in the financial statements and related notes are identified by the name of the caption beginning with a capital letter every time they appear in this Management's Discussion and Analysis.

Economic Environment

Following the downgrade of the U.S. government credit rating by S&P in August 2011 and growing concerns regarding the European sovereign debt crisis, world capital markets were marked by high volatility and general risk aversion in credit markets. During 2011, the trading investments portfolio experienced net mark-to-market gains of $9 million, compared to $396 million in 2010. Net losses of $59 million (relative to purchased price) were realized, compared to $19 million in 2010. The investment portfolio continued to perform except for $1.1 million of principal losses (2010—$2.1 million).

Despite the increased lending in response to the global financial crisis, the current economic situation, and the extension of the time for approval of the Ordinary Capital's increase, the capitalization of the Bank remains strong. In addition, the Bank's liquidity levels are robust and in line with Bank policy.

The volatility in the equity markets during the second half of the year affected the investment performance of the Bank's Pension and Postretirement Benefit Plans ("Plans"). In addition, the reduction in market interest rates increased the liabilities of the Plans. Most of these changes, which affect the funded status of the Plans, are recognized through comprehensive income. At December 31, 2011, the Balance Sheet shows Liabilities under retirement benefit plans of $796 million compared with net assets under retirement benefit plans of $89 million at December 31, 2010. The reduction in the funded status of the Plans of $885 million reflects an increase in benefit obligation of $917 million, to $4,801 million, mostly due to a decrease of 1% in the rate used to discount the liabilities. At the end of the year, the Plans' assets represented 83% of the benefit obligations compared with 102% at the end of the prior year. For further information, refer to Note S of the financial statements.

Financial Highlights

Lending Operations: **Box 1** presents the Bank's lending summary and other selected financial data. During 2011, the Bank's loan and guarantee approvals decreased by $1,736 million as compared to 2010. Approved loans amounted to $10,346 million (160 loans), compared to $12,075 million (162 loans) in 2010. The undisbursed portion of approved loans increased to $23,994 million at year-end 2011 from $22,357 million at year-end 2010.

During the year, three non-trade related guarantees without sovereign counter-guarantee were approved for $54 million (2010—four for $61 million). In addition, 268 trade finance guarantees in the aggregate amount of $621 million were issued (2010—131 guarantees in the aggregate amount of $239 million).

The portfolio of non-sovereign-guaranteed loans increased slightly to a level of $3,316 million compared to $3,224 million at December 31, 2010. In addition, the non-sovereign guarantees exposure increased $176 million to $847 million compared to $671 million the previous year. As of December 31, 2011, 6.2% of the outstanding loans and guarantees exposure was non-sovereign-guaranteed, compared to 6.1% at December 31, 2010.

Total allowances for loan and guarantee losses amounted to $175 million at December 31, 2011 compared to $172 million in 2010. The Bank had non-sovereign-guaranteed loans with outstanding balances of $129 million classified as impaired at December 31, 2011 compared to $140 million at December 31, 2010. All impaired loans have specific allowances for loan losses amounting to $41 million at December 31, 2011, compared to $55 million at December 31, 2010.

Flexible Financing Facility: Over the last few years, the Bank has been committed to developing and providing flexible, market-based financial products to borrowers to further enhance their asset liability management strategies. In line with this strategy, in 2011 the Bank approved the Flexible Financing Facility (FFF), effective on January 1, 2012. The FFF is now the only financial product platform for approval of all new Ordinary Capital sovereign-guaranteed loans. Through built-in features in FFF loans, borrowers have the ability to tailor financial terms at approval or during the life of a loan, subject to market availability and operational considerations. The FFF platform enables borrowers to: (i) manage currency, interest rate and other types of exposures; (ii) address project changing needs by customizing loan repayment terms to better manage liquidity risks; (iii) manage loans under legacy financial products; and, (iv) execute hedges with the Bank at a loan portfolio level.

Borrowing Operations: The Bank issued medium- and long-term debt securities for a total face amount of $6,798 million equivalent (2010—$13,719 million) that generated proceeds of $6,665 million equivalent (2010—$11,789 million) and had an average life of 6.8 years (2010—5.3 years). Such debt securities were issued through a strategy of combining large global benchmark bonds with smaller transactions targeted to particular segments of demand.

Financial Results: Operating Income for 2011 was $836 million, compared to $1,252 million in 2010, a decrease of $416 million. This decrease was due to lower net investment gains of $437 million, and higher net non-interest expense of $26 million, which were partially offset by higher net interest income of $33 million, and a decrease in the provision for loan and guarantee losses of $21 million.

For 2011, the Board of Executive Directors approved a lending spread of 0.80%, a credit commission of 0.25% and no supervision and inspection fee. While changes in interest rates will, over the long term, result in corresponding changes in operating income, the effect on a single year is relatively small due to the fact that equity is mostly funding fixed rate assets and that for debt-funded assets the interest rate exposure is mostly passed through to the borrowers or hedged through the use of derivative instruments.

With the election of the fair value option for a substantial number of the borrowings in 2008, the changes in fair value of the borrowing swaps are significantly offset by the changes in the fair values of the associated borrowings. However, income volatility still results from changes in the Bank's credit spreads and swap basis spreads, which affect the valuation of borrowings and swaps, respectively, the changes in fair value of lending swaps, which are not offset by corresponding changes in the fair value of loans, as all the Bank's loans are recorded at amortized cost, and the changes in fair value of equity duration swaps. To reduce the income volatility resulting from these financial instruments, effective January 1, 2011, the Bank modified its borrowing fair value option policy, addressing income volatility on a financial instruments portfolio basis rather than on an instrument-by-instrument basis.

During 2011, the Bank had net fair value losses on non-trading portfolios of $919 million, compared to $850 million in 2010. Fair value losses on lending swaps ($1,106 million) and losses associated with the changes in the Bank's credit spreads on the borrowing portfolio (approximately $192 million) were partially offset by gains on equity duration swaps of $287 million, gains on swaps for which the underlying bonds were not elected for fair value option ($71 million), and gains from changes in swap basis spreads (approximately $15 million). See Note R to the financial statements for further discussion on changes in fair value on non-trading portfolios.

Capitalization: To enhance the Bank's financial capacity following its response to the global economic crisis, the Board of Governors, on July 21, 2010, agreed to vote on a proposed resolution, as part of the ninth general increase in the resources of the Bank (IDB-9), that would provide for an increase in the Bank's Ordinary Capital of $70,000 million that would be subscribed to by Bank members in five annual installments, starting in 2011 through 2015. Of this amount, $1,700 million would be in the form of paid-in capital stock, payable in U.S. dollars, and the remainder would constitute callable capital stock. The increase was originally scheduled to enter into effect on October 31, 2011. On October 26, 2011, the Board of Executive Directors approved a resolution extending the deadline for approval of the Ordinary Capital increase and the date of the first subscription installment to January 31, 2012. See the Subsequent and Other Developments section for additional IDB-9 related developments occurring after December 31, 2011.

As part of the IDB-9, the Board of Governors agreed, in principle and subject to annual approvals and in accordance with the Agreement, to provide $200 million annually in transfers of Ordinary Capital income to the GRF, beginning in 2011 and though 2020. In March 2011, the Board of Governors approved the $200 million transfer corresponding to 2011.

The Total Equity-to-Loans Ratio (TELR) at December 31, 2011 was 31.3% compared to 33.4% at the end of the last year (See Table 7).

Asset and Liability Management: In 2010, the Board of Executive Directors approved the conversion of non-borrowing member country currency holdings subject to maintenance of value to United States dollars. Conversions of $3,225 million were carried out in December 2010 and May 2011. Settlement of maintenance of value obligations is being made upon consultation with each member country subject to the terms of the Bank's Charter. As a result, during 2011, the Bank made payments of $317 million to certain non-borrowing member countries.

As part of the asset/liability management policy, starting in 2010 it has been the Bank's policy to maintain basically all equity in United States dollars; as a result, net currency translation adjustments have been substantially reduced.

SUBSEQUENT AND OTHER DEVELOPMENTS

IDB-9: Effective January 18, 2012, the Board of Governors adopted a resolution authorizing the increase in the Bank's Ordinary Capital. On February 29, 2012, the increase in the Bank's Ordinary Capital entered into effect, which was also the effective date of the first installment. As of this date, commitments to subscribe from 46 member countries amounting to $65,731 million were received by the Bank and 5,134,300 shares of ordinary capital stock in the amount of $61,937 million or 88% of the total increase were eligible for allocation, representing the amount of shares committed to be subscribed, less shares that may not be allocated as of February 29, 2012 in order to comply with the associated minimum voting power requirements of the Agreement. Of this amount, $1,504 million represents paid-in capital stock and $60,433 million represents callable capital stock. The Board of Executive Directors approved a resolution, effective February 29, 2012, which extended the deadline to March 30, 2012 for member countries that have not subscribed to their respective shares of the increase. The Bank will issue additional ordinary capital stock in the amount of $8,063 million upon allocation of the remaining shares. In addition, on February 29, 2012, Canada notified the Bank of its intent to exercise its right to replace shares of non-voting callable capital stock with shares allocated under the IDB-9. See "Sources of Funds—Capitalization—Temporary Increase in Canada's Callable Capital" for further information.

Financial Reform—The Dodd-Frank Wall Street Reform and Consumer Protection Act: In July 2010, the President of the United States of America signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Act seeks to reform the U.S. financial regulatory system by introducing new regulators and extending regulation over new markets, entities, and activities. The implementation of the Act is dependent on the development of various rules to clarify and interpret its requirements. Pending the development of these rules, no impact on the Bank has been determined as of December 31, 2011. The Bank continues to assess the potential future impact of this financial regulatory reform on its operations.

Patient Protection and Affordable Care Act (PPACA) and Health Care and Education Reconciliation Act of 2010 (HCERA): In March 2010, the President of the United States signed into law the PPACA and the HCERA. The new legislation seeks to reform aspects of the U.S. health care system and its various provisions will be regulated and become effective over the following several years. It is the Bank's intention to implement provisions of the legislation to the extent not already reflected in the Bank's employee medical insurance program and as may be deemed appropriate given its status as an international organization. The Bank continues to closely monitor the implementation of the legislation. Management believes that the impact of the legislation will not be material to the Bank's financial position and results of operations.

The above information is qualified by the detailed information appearing elsewhere in this Management's Discussion and Analysis and the financial statements of the Ordinary Capital included in the Annual Report. In addition, this Management's Discussion and Analysis contains forward-looking information, which may be identified by such terms as "believes", "expects", "intends" or words of similar meaning. Such statements involve a number of assumptions and estimates that are based on current expectations, which are subject to risks and uncertainties beyond the Bank's control. Consequently, actual future results could differ materially from those currently anticipated. The Bank undertakes no obligation to update any forward-looking statements.

Box 1: Selected Financial Data

The following information is based upon, and should be read in conjunction with, the detailed information appearing in this Management's Discussion and Analysis and the financial statements of the Ordinary Capital included in this Annual Report.

(Amounts expressed in millions of United States dollars)

	Years ended December 31,				
	2011	2010	2009	2008	2007
Operational Highlights					
Loans and guarantees approved[(1)(2)]	$10,400	$12,136	$15,278	$11,085	$ 8,577
Gross loan disbursements	7,898	10,341	11,424	7,149	6,725
Net loan disbursements[(3)]	3,297	4,743	6,882	2,409	1,460
Balance Sheet Data					
Cash and investments-net[(4)], after swaps	$13,882	$16,585	$20,204	$16,371	$16,301
Loans outstanding[(5)]	66,130	63,007	58,049	51,173	47,954
Undisbursed portion of approved loans	23,994	22,357	21,555	19,820	16,428
Total assets	89,432	87,217	84,006	72,510	69,907
Borrowings outstanding[(6)], after swaps	58,015	57,874	57,697	47,779	45,036
Equity					
Callable capital stock[(7)]	100,641	100,641	100,641	96,599	96,613
(of which, subscribed by United States, Canada, Japan and the other nonregional members)	52,329	52,329	52,329	48,287	48,302
Paid-in capital stock	4,339	4,339	4,339	4,339	4,340
Retained earnings[(8)]	15,455	16,621	16,335	15,105	16,013
Total	19,794	20,960	20,674	19,444	20,353
Income Statement Data					
Loan income, after swaps	$ 1,742	$ 1,830	$ 2,002	$ 2,355	$ 2,436
Investment income (loss)	108	624	831	(973)	487
Other interest income	112	7	—	—	—
Borrowing expenses, after swaps	462	550	951	1,764	2,135
Loan and guarantee loss provision (credit)	3	24	(21)	93	(13)
Net non-interest expense	661	635	609	497	518
Operating Income (Loss)[(9)]	**836**	**1,252**	**1,294**	**(972)**	**283**
Net fair value adjustments on non-trading portfolios[(10)]	(919)	(850)	(500)	950	(149)
Board of Governors approved transfers	(200)	(72)	—	—	—
Net income (loss)	(283)	330	794	(22)	134
Ratios					
Net borrowings[(11)] as a percentage of callable capital stock subscribed by United States, Canada, Japan and the other nonregional members	86.3%	80.6%	74.1%	69.3%	61.2%
Interest coverage ratio[(12)]	2.81	3.28	2.36	0.45	1.13
Total Equity[(13)] to loans[(14)] ratio	31.3%	33.4%	34.2%	35.3%	40.2%
Cash and investments as a percentage of borrowings outstanding, after swaps	23.9%	28.7%	35.0%	34.3%	36.2%
Returns and Costs, after swaps					
Return on:					
Average loans outstanding	2.75%	3.12%	3.75%	4.85%	5.35%
Average liquid investments[(15)]	0.65%	3.37%	4.29%	(5.27%)	2.93%
Average earning assets	2.35%	3.14%	3.91%	2.12%	4.69%
Average cost of:					
Borrowings outstanding during the year	0.81%	0.96%	1.78%	3.84%	4.92%
Total funds available	0.59%	0.71%	1.32%	2.66%	3.36%

(1) In 2009, includes $800 million of loan approvals cancelled during the year.
(2) Excludes guarantees issued under the Trade Finance Facilitation Program.
(3) Includes gross loan disbursements less principal repayments.
(4) Net of Payable for investment securities purchased and cash collateral received and Receivable for investment securities sold.
(5) Excludes lending swaps in a net liability position of $1,546 million in 2011 (2010—net liability of $655 million; 2009—net asset of $77 million).
(6) Net of premium/discount.
(7) From 2009, includes $4,039.9 million capital subscription received from Canada for 334,887 shares of non-voting callable capital stock redeemable from 2014 to 2017.
(8) Includes Accumulated other comprehensive income.
(9) See page 17 for a full discussion of Operating Income.
(10) Net fair value adjustments on non-trading portfolios mostly relate to (a) the changes in the fair value of the Bank's lending swaps due to changes in USD interest rates (and for which the offsetting changes in value of the loans are not recognized since the loans are not fair valued), as well as (b) the changes in the fair value of the Bank's borrowings due to changes in the Bank's own credit spreads. See Note R to the financial statements for further details.
(11) Borrowings (after swaps) and gross guarantee exposure, less qualified liquid assets (after swaps).
(12) The interest coverage ratio is computed using Operating Income (Loss).
(13) "Total Equity" is defined as Paid-in capital stock, Retained earnings and the allowances for loan and guarantee losses, minus borrowing countries' local currency cash balances, net receivable from members (but not net payable to members) and the cumulative effects of Net fair value adjustments on non-trading portfolios.
(14) Includes loans outstanding and net guarantee exposure.
(15) Geometrically-linked time-weighted returns.

DEVELOPMENT OPERATIONS

General

The Bank makes loans and guarantees to the governments, as well as governmental entities, enterprises, and development institutions of its borrowing member countries to help meet their development needs. In the case of loans and guarantees to borrowers other than national governments or central banks, the Bank follows the policy of requiring a joint and several guarantee engaging the full faith and credit of the national government. Loans and guarantees may also be made directly to other eligible entities carrying out projects in the territories of borrowing member countries, including private sector entities or sub-sovereign entities, without a sovereign guarantee and in all sectors, provided they meet the Bank's lending criteria. The Bank also provides financing to borrowing member countries for non-reimbursable and contingent recovery assistance that is aligned with its overall strategy for the region.

Development Objective

The Bank's objective is to promote sustainable growth, poverty reduction and social equity. The Report on the Ninth General Increase in the Resources of the Bank identifies five sector priorities to work towards achieving this objective:

- Social policy for equity and productivity.
- Infrastructure for competitiveness and social welfare.
- Institutions for growth and social welfare.
- Competitive regional and global international integration.
- Protection of the environment, response to climate change, promotion of renewable energy and ensuring food security.

Lending Cycle

The process of identifying and assessing a project and approving and disbursing a loan often extends over several years, depending on the nature, objective and purpose of the individual project. However, on numerous occasions the Bank has shortened the preparation and approval cycle in response to emergency situations such as natural disasters or economic crises. Generally, the Bank's operational staff (economists, engineers, financial analysts and other sector and country specialists) assess the projects. With certain exceptions, the Bank's Board of Executive Directors must approve each loan.

Loan disbursements are subject to the fulfillment of conditions set forth in the loan agreement. During implementation of the Bank-supported operations, experienced Bank staff review progress, monitor compliance with Bank policies and assist in resolving any problems that may arise. An independent Bank unit, the Office of Evaluation and Oversight, pursuant to an annual work plan approved by the Board of Executive Directors, evaluates some operations to determine the extent to which they have met their major objectives, and these evaluations are reported directly to the Board of Executive Directors.

The Bank's lending operations conform to certain principles that, when combined, seek to ensure that loans made to member countries are for financially and economically sound purposes to which these countries have assigned high priority, and that funds lent are utilized as intended. These principles are detailed in **Box 2**.

Loans

The Bank's sovereign-guaranteed lending generally falls into one of two categories: investment loans for specific projects, including loans to intermediaries for on-lending purposes, or

Box 2: Lending Operations Principles

(i) The Bank makes sovereign-guaranteed loans and guarantees primarily to the public sector governments, as well as governmental entities, enterprises, and development institutions of its borrowing members. In addition, the Bank makes non-sovereign-guaranteed loans and guarantees to eligible entities and other development institutions.

(ii) Loan applicants must submit a detailed proposal to the Bank specifying the technical, economic and financial merits of the project. The proposal must include an evaluation of the project's expected environmental risks or impact and proposed mitigation measures as well as its impact on women and indigenous groups, as applicable.

(iii) The Bank neither renegotiates nor takes part in debt rescheduling agreements with respect to its sovereign-guaranteed loans.

(iv) Loan agreements typically include a negative pledge clause that generally prohibits a borrower from creating any encumbrances on its assets or revenues with respect to its foreign currency debt, unless the Bank is equally and proportionally secured. The Board of Executive Directors has granted limited waivers in the past.

(v) In making loans, the Bank evaluates the capacity of the borrower to carry out its financial obligations under the loan agreement, the prevailing macroeconomic climate and debt burden of the country, and policy and institutional issues relevant to the loan.

(vi) The Bank considers the ability of the borrower to obtain private financing under reasonable terms and conditions. The Bank serves as a catalyst to promote private investment, not to compete with it.

(vii) The use of loan proceeds is supervised. Bank staff monitor and supervise the ongoing progress with respect to the development objectives of each operation through the Bank's Country Offices in each of its 26 borrowing member countries, and fiduciary arrangements are in place to ensure proper use of Bank resources to achieve the operation's objectives.

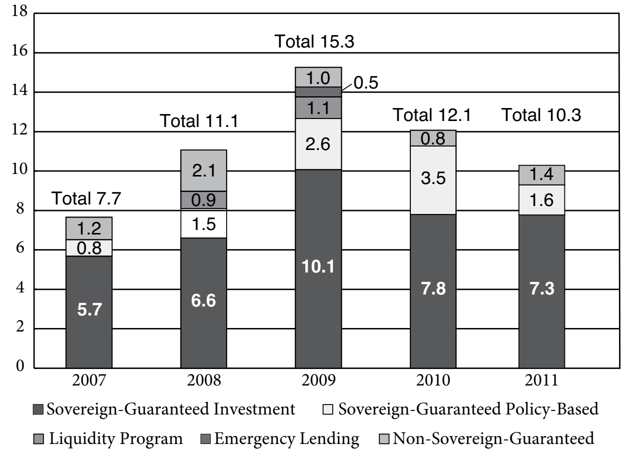
policy-based loans. Investment lending is generally used to finance goods, works and services in support of economic and social development projects in a broad range of sectors. Policy-based lending generally supports social, structural and institutional reforms with the aim of improving specific sectors of the borrowers' economies and promoting sustainable growth. These loans support the following economic sectors: energy, industry and mining, agriculture and fisheries, transportation and communications, trade finance, education, science and technology, water, sanitation and health, tourism, urban development, planning and reform, modernization of the state and the environment, as well as project preparation. The Bank has also instituted an emergency lending program to address financial or economic crises.

In addition, the Bank lends directly to eligible entities without a sovereign guarantee for the financing of investments for transactions in all sectors, subject to an exclusion list. These loans and guarantees are made on the basis of market-based pricing and are subject to certain eligibility requirements and volume limits. The Bank also lends to other development institutions for on-lending purposes without a sovereign guarantee. Non-sovereign-guaranteed operations are currently capped to an amount such that risk capital requirements for such operations do not exceed 20 percent of Total Equity. As of September 30, 2011 (the date of the latest quarterly report to the Board of Executive Directors), the risk capital requirements of non-sovereign-guaranteed operations was $1,091 million, or 5.0% of Total Equity.

Non-sovereign-guaranteed loans and guarantees are also subject to certain limits, including a ceiling on financing the lesser of (a) $200 million and (b) (i) 50% of the total project cost for expansion projects and credit guarantees irrespective of the country, subject to such financing not exceeding 25% (certain smaller countries 40%) of the borrower or obligor's total capitalization of debt and equity or (ii) 25% of the total project cost (certain smaller countries 40%) for new projects. The Bank can also provide political risk guarantees of up to the lesser of $200 million or 50% of the total project cost. In exceptional circumstances, the Board of Executive Directors may approve loans and credit and political guarantees of up to $400 million. The Bank's maximum exposure to any single obligor for non-sovereign-guaranteed operations cannot exceed the lesser of (i) 2.5% of the Bank's equity and (ii) $500 million at the time of approval. In addition, the Bank has established sector limits to maintain a diversified portfolio across sectors.

Figure 1 presents a breakdown of approvals by loan type during the last five years. Over the past five years, sovereign-guaranteed investment lending per year has fluctuated between $5.7 billion and $10.1 billion, policy-based lending between $0.8 billion and $3.5 billion, and non-sovereign-guaranteed lending between $0.8 billion and $2.1 billion. There were no emergency loan approvals in 2011 and 2010.

Figure 1: LOAN APPROVALS BY TYPE
For the years ended December 31, 2007 through 2011
(Expressed in billions of United States dollars)



During 2011, loan approvals totaled $10,346 million compared to $12,075 million in 2010. A summary of loan approvals by country during 2011 and 2010 appears in **Table 1**. By loan type, investment and policy-based loan approvals decreased $424 million and $1,934 million, respectively, while non-sovereign-guaranteed loan approvals increased $629 million.

Table 1: LOAN APPROVALS BY COUNTRY[(1)]
For the years ended December 31, 2011 and 2010
(Expressed in millions of United States dollars)

COUNTRY	2011	2010
Argentina	$ 1,313	$ 1,165
Bahamas	131	—
Barbados	70	85
Belize	10	10
Bolivia	196	141
Brazil	2,188	2,260
Chile	92	69
Colombia	730	685
Costa Rica	132	92
Dominican Republic	465	335
Ecuador	569	509
El Salvador	263	435
Guatemala	50	291
Guyana	8	18
Honduras	129	250
Jamaica	328	630
Mexico	1,560	2,952
Nicaragua	54	125
Panama	228	340
Paraguay	157	152
Peru	450	341
Suriname	80	12
Trinidad and Tobago	290	140
Uruguay	318	88
Venezuela	120	890
Regional	415	60
Total	$10,346	$12,075

(1) Includes non-sovereign-guaranteed loans.

At December 31, 2011, the total volume of outstanding loans was $66,130 million, $3,123 million higher than the $63,007 million at December 31, 2010. This increase was mainly due to a higher level of loan disbursements ($7,898 million) than collections ($4,601 million, including prepayments of $287 million). Undisbursed balances at December 31, 2011, totaled $23,994 million, an increase of $1,637 million from December 31, 2010. This change was mainly due to higher loan approvals than disbursements, partially offset by cancellations.

During 2011, the portfolio of non-sovereign-guaranteed loans increased to a level of $3,316 million compared to $3,224 million at December 31, 2010. In addition, the non-sovereign guarantee exposure increased $176 million to $847 million compared to $671 million the previous year. As of December 31, 2011, 6.2% of the outstanding loans and guarantees exposure was non-sovereign-guaranteed, compared to 6.1% at December 31, 2010.

A summary statement of loans outstanding by country at December 31, 2011 and 2010 is set forth in Appendix I-2 to the financial statements.

Financial Terms of Loans

Currently Available Financial Terms: In 2011, the Bank approved the FFF, effective on January 1, 2012. The FFF is now the only financial product platform for approval of all new Ordinary Capital sovereign guaranteed loans. Through built-in features in FFF loans, borrowers have the ability to tailor financial terms at approval or during the life of a loan, subject to market availability and operational considerations. The FFF platform enables borrowers to: (i) manage currency, interest rate and other types of exposures; (ii) address project changing needs by customizing loan repayment terms to better manage liquidity risks; (iii) manage loans under legacy financial products; and, (iv) execute hedges with the Bank at a loan portfolio level. The FFF loans have an interest rate based on LIBOR plus a funding margin, as well as the Bank's spread. The Bank also offers emergency loans with sovereign guarantee. **Table 2** presents the available terms for sovereign-guaranteed loans approved after December 31, 2011.

The Bank offers loans to eligible entities without sovereign guarantees, under various terms. Non-sovereign-guaranteed loans can be denominated in United States dollars, Japanese yen, euro,

Table 2: CURRENTLY AVAILABLE FINANCIAL TERMS OF LOANS WITH SOVEREIGN GUARANTEE

		Flexible Financing Facility	Emergency Lending Facility
Interest rate option		LIBOR-based loans[(3)]	LIBOR-based loans
Currencies offered	**Approval**	USD or borrowing member local currency	USD
	Disbursement	Currency of approval or converted currency	
	Repayment	Currency disbursed/converted	
Cost Base		LIBOR ± funding margin, currency equivalent of LIBOR ± funding margin, or actual funding cost	6-month LIBOR
Funding Margin to LIBOR		Actual funding margin or estimated funding margin at the time of disbursement/conversion	Not applicable
Lending Spread[(1)(2)]		62[(5)]	400
Credit commission[(1)(2)]		25[(5)]	75
Supervision and inspection fee[(1)(2)]		0[(5)]	Not applicable
Front-end fee[(1)]		Not applicable	100
Maturity[(4)]		Up to 20 years for policy based loans and up to 25 years for investment loans	5 years
Grace Period		For investment loans: 6 months after original disbursement period. For policy-based loans: 5 years.	3 years
Repayment Profile		Flexible repayment profile based on loan's contractual weighted average life.	Not applicable

(1) Loan charges expressed in basis points (bps).
(2) Loan charges on sovereign-guaranteed loans, excluding emergency lending, are established annually by the Board of Executive Directors. In no case can the credit commission exceed 0.75% or the inspection and supervision fee exceed, in a given six-months period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.
(3) FFF LIBOR-based loan balances can be converted to fixed-base cost rate or to any member currency, subject to market availability.
(4) For "parallel loans" (a blending of loans from the Ordinary Capital and the FSO) maturity is 30 years and grace period is 6 years.
(5) Loan charges effective January 1, 2012.

Swiss franc or local currency, and borrowers have the option of either fixed interest rate loans or floating rate loans. For floating rate loans, the interest rate resets every one, three or six months based on a LIBOR rate plus the lending spread. Lending spreads and fees are set on a case-by-case basis.

Previously Available Financial Terms: Up to December 31, 2011, the Bank offered two basic types of sovereign-guaranteed loans, each denominated in the currency or currencies chosen by the borrower, as available under the programs: Single Currency Facility (SCF) LIBOR-based loans and Local Currency Facility (LCF) loans.

SCF LIBOR-based loans have an interest rate that is adjusted quarterly, based on the currency-specific three-month LIBOR plus a pool-based margin reflecting the Bank's funding cost, as well as the Bank's spread. Borrowers have the option to convert their SCF LIBOR loan balances to fixed-base cost rate.

For loans approved under the LCF, public and private sector borrowers have the option to receive local currency financing under three different modalities: i) direct local currency financing or conversion of future loan disbursements and/or outstanding loan balances; ii) direct swaps into local currency against existing Bank debt; and iii) local currency disbursement of called guarantees. The use of these modalities is subject to the availability of the respective local currency and the appropriate risk mitigation instrument(s) in the financial markets. Outstanding loan balances in the LCF carry a fixed-base cost, floating or inflation-linked interest rate. The LCF was incorporated into the FFF product for sovereign-guaranteed loans effective January 1, 2012 and is still available for non-sovereign-guaranteed operations. At December 31, 2011, the Bank had local currency loans outstanding of $2,128 million, which were swapped back-to-back to United States dollars.

Up to June 30, 2009, the Bank offered SCF adjustable rate loans with interest rates adjusted every six months to reflect the currency-specific effective cost during the previous six months of the pool of borrowings allocated to fund such loans, plus the Bank's lending spread.

In the past, the Bank also offered loans under the Currency Pooling System (CPS). For these loans, the Bank historically maintained a targeted currency composition of 50% United States dollars, 25% Japanese yen and 25% European currencies. With the approval of the FFF product in 2011, the Board of Executive Directors also approved to gradually convert the currency composition of these loans to 100% United States dollars. Loans approved prior to 1989 carry a fixed interest rate while loans approved from 1990 to 2003 carry an adjustable rate. The adjustable rate, which resets twice a year, represents the effective cost during the previous six months of a pool of borrowings allocated to fund such loans, plus the Bank's lending spread.

Up to June 2007, the Bank also offered fixed rate and LIBOR-based U.S. Dollar Window Program loans with sovereign guarantee, destined for on-lending to private sector borrowers. In addition, effective in 2008 and up to December 31, 2009, the Bank offered loans under the Liquidity Program, a program for loans within the emergency lending category.

Conversion of SCF and CPS Adjustable Rate Loans to LIBOR-Based Loans: In 2009 and 2010, the Bank converted outstanding loan balances of $31,956 million as follows: $3,036 million of CPS to USD LIBOR-based rate, $6,639 million of CPS to USD fixed-base cost rate, $1,929 million of SCF to USD LIBOR-based rate, and $20,352 million of SCF to fixed-base cost rate.

Table 3 presents a breakdown of the loan portfolio by loan product. For more information, see Appendix I-3 to the financial statements.

Table 3: LOANS OUTSTANDING BY LOAN PRODUCT[1]
December 31, 2011 and 2010
(Amounts expressed in millions of United States dollars)

	2011		2010	
	Amount	**%**	**Amount**	**%**
SCF-LIBOR-based	$29,554	44.7	$25,322	40.2
SCF-fixed-base cost	27,483	41.6	28,409	45.1
SCF-adjustable	1,397	2.1	1,305	2.1
LCF	2,048	3.1	2,110	3.3
Emergency lending	500	0.8	500	0.8
Liquidity Program	98	0.1	102	0.2
Non-sovereign-guaranteed-fixed	766	1.2	627	1.0
Non-sovereign-guaranteed-floating	2,297	3.5	2,363	3.8
Non-sovereign-guaranteed-local currency	80	0.1	45	0.1
Currency Pooling System	1,380	2.0	1,603	2.5
U.S. Dollar Window	336	0.5	415	0.7
Others	191	0.3	206	0.2
Total	$66,130	100.0	$63,007	100.0

[1] Non-sovereign-guaranteed loans in the amount of $173 million (2010—$189 million) to other development institutions are included in SCF-LIBOR-based, U.S. Dollar Window and Others, as applicable.

Of the $23,994 million undisbursed loan balances at December 31, 2011, 84% pertains to the SCF LIBOR-based, 4% to the SCF-adjustable and 11% to the non-sovereign-guaranteed-floating portfolios.

The Bank uses currency and interest rate swaps in order to hedge exposures from loans where either a cost pass-through of the funding cost is not applicable or the currency of the loans is not the same as the one of the underlying funding.

Charges on Loans with Sovereign Guarantee
(Excluding Emergency Lending)

Loan charges are established annually by the Board of Executive Directors taking into consideration the trade-offs presented in the Long-Term Financial Projections (see "Financial Risk Management—Capital Adequacy Framework—Income Management Model" below). At a minimum, the level of loan charges for sovereign-guaranteed loans should be sufficient to generate enough income so as to cover 90% of the Ordinary Capital´s administrative expenses, adjusted for 90% of the income from the Bank´s non-sovereign-guaranteed operations.

During late 2011, the Board of Executive Directors approved lending spreads for 2012 of 0.62%, a credit commission of 0.25% and no supervision and inspection fee. **Table 4** shows loan charges prevailing during the periods indicated.

Table 4: LOAN CHARGES

	Lending spread %	Credit commission %	Supervision and inspection fee %
2009:			
First semester	0.30	0.25	—
Second semester	0.95	0.25	—
2010:			
First semester	0.95	0.25	—
Second semester	0.95	0.25	—
2011:			
First semester	0.80	0.25	—
Second semester	0.80	0.25	—

Guarantees

The Bank may make political risk and partial credit guarantees either without a sovereign counter-guarantee under the limit established for non-sovereign-guaranteed operations, or with a member country sovereign counter-guarantee. These guarantees are denominated in United States dollars or in local currency.

As part of its non-sovereign-guaranteed lending activities, the Bank has issued political risk and partial credit guarantees designed to encourage private sector infrastructure investments, local capital market development, and trade finance. The political risk guarantees and partial credit guarantees may be offered on a stand-alone basis or in conjunction with a Bank loan. Political risk guarantees cover specific risk events related to noncommercial factors (such as currency convertibility, transferability of currencies outside the host country, and government non-performance). Partial credit guarantees cover payment risks for debt obligations or trade-finance transactions. The terms of all guarantees are specifically set in each guarantee agreement and are primarily tied to a project, the terms of debt issuances or trade-finance transactions. On a case-by-case basis, depending upon the risks covered and the nature of each individual project, the Bank may reinsure certain guarantees to reduce its exposure. Guarantee exposure is measured as the future guaranteed cash flows, net of reinsurance, when applicable, discounted to the current period.

During 2011, three non-trade-related guarantees without sovereign counter-guarantee were approved for $54 million (2010—four for $61 million). In addition, the Bank's Trade Finance Facilitation Program (TFFP) provides full credit guarantees without sovereign counter-guarantees on trade-finance transactions. This Program authorizes lines of credit in support of approved issuing banks, with an aggregate program limit of up to $1,000 million outstanding at any time. During 2011, 268 trade-finance guarantees in the aggregate amount of $621 million were issued. This compares with 131 guarantees in the aggregate amount of $239 million issued in 2010.

As of December 31, 2011, guarantees of $980 million (2010—$814 million), including $418 million issued under the TFFP (2010—$153 million), were outstanding and subject to call. No guarantees have ever been called. The net present value of guarantee exposure on non-sovereign guarantees, net of reinsurance, was $847 million at December 31, 2011 (2010—$671 million).

Technical Assistance

In addition to loans and guarantees, the Bank provides technical assistance to its member countries both in connection with, and independent of, its lending operations. Such assistance focuses on transferring knowledge, and supports project preparation, feasibility studies, regional programs and training. Technical assistance activities are funded by resources from the Ordinary Capital's special programs, funds under administration, and, up to December 31, 2010, FSO resources. In 2011, the Bank approved technical assistance for a total of $242 million (2010—$296 million), including $88 million (2010—$86 million) funded by the Ordinary Capital.

LIQUIDITY MANAGEMENT

The Bank invests its liquid assets in highly rated securities and bank deposits. These instruments include obligations of highly-rated governments, government agencies, multilateral organizations, financial institutions, and corporate entities, including asset-backed securities. In addition, the Bank uses derivatives, mostly currency and interest rate swaps, to manage its investment portfolios.

Liquidity plays a key role in the management of the Bank's funding risks by addressing the risk that the Bank may not have adequate funds to meet both future loan disbursement and debt service obligations. The objective of liquidity management is to ensure that adequate resources are available to meet anticipated contractual obligations and to ensure uninterrupted financial operations in the event the Bank were to refrain from borrowing in response to unattractive market conditions or other constraints. The Bank's liquidity management principles are set forth in **Box 3**.

The Bank's liquidity policy targets an investment portfolio sufficient to cover between six and twelve months of debt repayments and loan disbursements. The policy allows Management to manage liquidity dynamically based on the Bank's expected future cash flow needs. It requires a liquidity level ranging within a band established early in the year and sent to the Board of Executive Directors for their information. Liquidity for this purpose is essentially defined as non-borrowing countries convertible currency cash and investments, excluding the assets funded by the Bank's Discount Note Program and assets with limited or restricted availability. The policy band may be reviewed during the year depending on whether or not there are any changes in the components that generate the band (i.e., loan disbursements and debt redemptions, as well as net guarantee exposure). At December 31, 2011, liquidity was $12,810 million, within policy limits. During the year, liquidity, as defined, averaged $14,311 million compared to $15,615 million in 2010.

The Bank has short-term borrowing facilities that consist of a discount note program and uncommitted borrowing lines from various commercial banks. Discount notes are issued in amounts of not less than $100,000, with maturities of no more than 360 days. These funding facilities are used to manage short-term cash flow needs.

> **Box 3: Liquidity Management Principles**
>
> The primary objective in the management of the Bank's liquid assets is preservation of capital, and maintaining a portfolio of adequate size invested in high quality liquid assets to enable the Bank to meet its financial obligations even at times when access to the capital markets becomes temporarily impaired. The secondary investment objective is to efficiently manage risk/return trade-offs of all eligible asset classes within the defined risk tolerance of the Bank, in order to help minimize the cost of carrying liquidity.
>
> The Bank manages its liquidity through financial policies, instruments and guidelines, which serve as the rules, procedures and tools that define the Bank's liquidity management. The Investment Resolution approved by the Board of Executive Directors provides the basic authority within which liquidity is invested. The Investment Guidelines approved by Management establish the detailed operating, compliance and monitoring conditions for the implementation of the liquidity management. Both are designed to ensure that the Bank assesses market and credit risks, and establishes investment constraints consistent with the Bank's level of risk tolerance. For information concerning the management of risk exposures on liquidity see "Financial Risk Management" below.

Liquid investments are maintained in two distinct subportfolios: transactional and operational, (trading investments portfolio) each with different risk profiles and performance benchmarks. Up to December 2010, the Bank also maintained a Held-to-Maturity (HTM) portfolio. The transactional portfolio is used to meet the day-to-day cash flow requirements. The operational portfolio holds the majority of the Bank's liquid holdings.

Investments of up to 10% of the portfolio may be contracted out to external managers. At December 31, 2011, the Bank had no investments managed by external firms (2010—$571 million or 3.4% of the investments portfolio).

The returns of the liquid investment portfolios in 2011 and 2010 are shown in **Table 5**. The decrease in the return of the trading investments portfolio in 2011, as compared to 2010, is primarily due to the high volatility and general risk aversion in credit markets, which resulted in substantially lower mark-to-market investment gains, and lower overall interest rates. The return of the HTM portfolio in 2010 includes the recognition of unrealized gains as a result of the discontinuation of the portfolio in December 2010. Excluding these gains, which amounted to $54 million, the HTM portfolio return would have been 2.39%.

Performance and Exposure of Liquid Investments Portfolio
Following the downgrade of the U.S. government credit rating by S&P in August 2011 and growing concerns regarding the European sovereign debt crisis, world capital markets were marked by high volatility and general risk aversion in credit markets.

Table 5: LIQUID INVESTMENT PORTFOLIOS[1]
December 31, 2011 and 2010
(Amounts expressed in millions of United States dollars)

	2011		2010	
Portfolio	**Ending Balance**	**Financial Return (%)[2][3][4]**	**Ending Balance**	**Financial Return (%)[2][3][4]**
Transactional	$ 3,524	0.18	$ 4,504	0.21
Operational	10,080	0.76	11,852	4.51
Held-to-Maturity	—	—	—	4.41
Overall Portfolio	$13,604	0.65	$16,356	3.37

[1] After swaps and net of payable and receivable for investment securities purchased or sold.
[2] Combined return for all currencies in each portfolio.
[3] Geometrically-linked time-weighted returns.
[4] Includes gains and losses.

Exposure to structured assets continued to be reduced through repayments at par of $927 million (2010—$1,011 million) and selected asset sales. The volatility and limited liquidity in the asset-backed and mortgage-backed securities markets continued to affect the Bank's ability to mitigate its credit risk by selling or hedging its exposures. Nevertheless, certain subsectors improved, permitting the execution of limited sales thereby reducing exposure at higher prices. Valuations on the remaining portfolio continue to be impacted by market factors, such as uneven liquidity, rating agency actions, and the prices at which actual transactions occur. The Bank continues to maximize, where possible, the use of the market inputs in the valuation of its investments, including external pricing services, independent dealer prices, and observable market yield curves.

The Bank continues to closely monitor the asset quality of its investments portfolio, analyzing and assessing the fundamental value of its securities, with a particular focus on its asset-backed and mortgage-backed securities.

In 2011, the Bank recognized $9 million of mark-to-market gains in its trading investments portfolio (2010—$396 million). These investment gains mostly relate to gains recognized in the first half of the year in the $2,019 million (2010—$2,968 million) asset-backed and mortgage-backed securities portion of the portfolio that were substantially reversed by a decline in valuations across asset classes in the second half of the year in response to increased risk aversion in the credit markets. As of December 31, 2011, 13.5% of the asset-backed and mortgage-backed securities portion of the portfolio was rated AAA and 72.9% was rated investment grade compared to 38.3% and 78.0%, respectively, at December 31, 2010. The reduction in AAA holdings came mainly as a result of downgrades into other investment grade categories.

The exposure for the whole investment portfolio, excluding swaps, amounted to $13,743 million at December 31, 2011 compared to $16,394 million at December 31, 2010. The quality of the overall portfolio continues to be high, as 88.3% of the credit exposure is rated AAA and AA (2010—78.9%), 0.8% carry the highest short-term ratings (A1+) (2010—11.6%), 4.3% is rated A (2010—4.1%), and 6.6% is rated below A/A1+ (2010—5.4%). The investment portfolio continued to perform except for $1.1 million of principal losses (2010—$2.1 million). Net losses of $59 million (relative to purchased price) were realized, compared to $19 million in 2010.

Table 6 shows a breakdown of the trading investments portfolio at December 31, 2011 and 2010 by major security class together with unrealized gains and losses included in Income from Investments-Net gains on securities held at the end of the respective year.

Table 6: TRADING INVESTMENTS PORTFOLIO BY MAJOR SECURITY CLASS
December 31, 2011 and 2010
(Amounts expressed in millions of United States dollars)

	2011		2010	
Security Class	**Fair Value[1]**	**Unrealized Gains (Losses)[2]**	**Fair Value[1]**	**Unrealized Gains (Losses)[2]**
Obligations of the United States Government and its corporations and agencies	$ 1,974	$ —	$ 822	$ —
U.S. Government-sponsored enterprises	841	—	505	(7)
Obligations of non-U.S. governments and agencies	5,586	(7)	7,045	8
Bank obligations	3,323	(6)	5,054	(2)
Mortgage-backed securities	**1,269**	**(41)**	**1,925**	**165**
U.S. residential	444	(7)	573	87
Non-U.S. residential	419	(54)	875	21
U.S. commercial	167	13	182	44
Non-U.S. commercial	239	7	295	13
Asset-backed securities	**750**	**27**	**1,043**	**106**
Collateralized loan obligations	470	22	633	64
Other collateralized debt obligations	125	4	152	30
Other asset-backed securities	155	1	258	12
Total trading investments	13,743	(27)	16,394	270
Currency and interest rate swaps—investments-trading	(96)	(41)	(71)	(8)
Total	$13,647	$(68)	$16,323	$262

(1) Includes accrued interest of $40 million (2010—$38 million) and $(27) million (2010—$(23) million), presented in the Balance Sheet under Accrued interest and other charges-on investments and Accrued interest and other charges-on swaps-net, respectively.

(2) Represents unrealized gains and losses included in Income from Investments—Net gains for the corresponding year.

Contractual Obligations

In the normal course of business, the Bank enters into various contractual obligations that require future cash payments. The most significant contractual obligations relate to the repayment of borrowings. The maturity structure of medium- and long-term borrowings outstanding at December 31, 2011 is presented in Appendix I-4 to the financial statements. In addition, the Bank has a number of other obligations to be settled in cash, which are reflected in its financial statements, including undisbursed loans, short-term borrowings, payable for currency and interest rate swaps, Payable for investment securities purchased and cash collateral received, Due to IDB Grant Facility, and Liabilities under retirement benefit plans.

SOURCES OF FUNDS

Equity

Equity at December 31, 2011 was $19,794 million compared with $20,960 million at December 31, 2010. The decrease of $1,166 million primarily reflects Other comprehensive loss of $883 million (essentially composed of the effect of the decrease in the funded status of the Bank's pension and postretirement plans of $880 million), Net fair value adjustments on non-trading portfolios of $919 million, and Board of Governors approved transfers of $200 million, partially offset by Operating Income of $836 million.

The Bank's equity base plays a critical role in securing its financial objectives, enabling the Bank to absorb risk out of its own resources and protecting member countries from a possible call on callable capital stock. **Table 7** presents the composition of the TELR at December 31, 2011 and 2010. See "Financial Risk Management—Credit Risk—Capital Adequacy Framework" for further information.

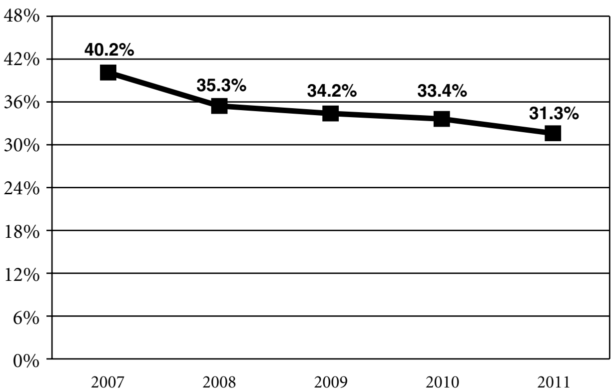
Table 7: TOTAL EQUITY-TO-LOANS RATIO
December 31, 2011 and 2010
(Amounts expressed in millions of United States dollars)

	2011	2010
Equity:		
Paid-in capital stock	$ 4,339	$ 4,339
Retained earnings:		
General reserve[1]	12,890	14,056
Special reserve[1]	2,565	2,565
	19,794	20,960
Plus:		
Allowances for loan and guarantee losses	175	172
Minus:		
Borrowing countries' local currency cash balances	173	136
Net receivable from members	76	—
Cumulative net fair value adjustments on non-trading portfolios	(1,241)	(322)
Total Equity	$20,961	$21,318
Loans outstanding and net guarantee exposure	$67,030	$63,731
Total Equity-to-Loans Ratio	**31.3%**	**33.4%**

(1) Includes Accumulated other comprehensive income.

As presented in **Table 7,** the TELR decreased from 33.4% at December 31, 2010, to 31.3% at December 31, 2011. The decrease was mainly due to an increase of $3,299 million in loans outstanding and net guarantee exposure and a decrease in Total Equity of $357 million, mostly resulting from Other comprehensive loss of $883 million and Board of Governors approved transfers of $200 million, partially offset by Operating Income of $836 million. **Figure 2** presents the changes in the TELR during the last five years. Prior to 2007, this ratio had increased steadily as a result of the growth in the Total Equity and lower loans outstanding. From 2008, the ratio reflects the increase in Bank lending to the region.

Figure 2: TOTAL EQUITY-TO-LOANS RATIO



Capitalization

Shareholders' support for the Bank is reflected in the capital backing it has received from its members. At December 31, 2011, subscribed capital stock was $104,980 million, of which $4,339 million had been paid-in and $100,641 million was callable.

Paid-in and callable capital stock subscriptions are payable as follows:

Paid-in Capital Stock: Each subscription to paid-in capital stock has been paid, in whole or in part, in United States dollars or the currency of the respective member country. In the case of most payments made in the currency of the respective member country, the member country has made arrangements satisfactory to the Bank to assure that, subject to the provisions of the Agreement, its currency will be freely convertible (or the member country has agreed to convert its currency on behalf of the Bank) into the currencies of other countries for the purposes of the Bank's operations. The Bank has accepted non-negotiable, non-interest-bearing demand obligations in lieu of the immediate payment of all or a part of the member's subscription to the paid-in capital stock. Under the Agreement such obligations are accepted where currencies are not required for the Bank's operations.

Callable Capital Stock: The callable portion of the capital stock subscriptions is subject to call only when required and to the extent necessary to meet the obligations of the Bank on borrowings of funds or guarantees. In the event of a call, payment may be made at the option of the member in gold, United States dollars, fully convertible currency of the member country or in the currency required to discharge the obligations of the Bank for the purpose for which the call is made. Calls are required to be uniform, but obligations of the members of the Bank to make payment upon such calls are independent of each other. Failure of one or more members to make payments on any such call would not excuse any other member from its obligation to make payment, and successive calls could be made on non-defaulting members if necessary to meet the Bank's obligations. However, no member could be required on any such call to pay more than the unpaid balance of its capital stock subscription. No call has ever been made on the Bank's callable capital stock.

At December 31, 2011, the total subscription of the United States, the Bank's largest shareholder, was $30,310 million, of which the United States had paid $1,303 million as subscriptions to the Bank's paid-in capital stock. Of the United States' callable capital stock subscription of $29,007 million, $3,800 million had been fully authorized and appropriated, without fiscal year limitation, by United States legislation, and no further appropriation is necessary to enable the Secretary of the Treasury to pay this amount if any part were to be called to meet obligations of the Bank. The balance of the United States' callable capital stock subscription, $25,207 million, has been authorized by the United States Congress but not yet appropriated. In 1979, in connection with the United States' subscription to an increase in the callable capital stock, the Bank obtained an opinion of the General Counsel of the Treasury stating that appropriations were not legally required to back subscriptions to such callable capital stock unless and until payment was required of the United States on a call made by the Bank. The opinion further states that an appropriation is not required to make United States callable capital stock subscriptions, authorized by United States legislation, binding obligations backed by the full faith and credit of the United States, and that an obligation contracted by the United States pursuant to a Congressional grant of authority for constitutional purposes is fully binding on the United States notwithstanding that a future appropriation might be necessary in order to fund that obligation.

Temporary Increase in Canada's Callable Capital: In 2009, Canada subscribed to 334,887 shares of non-voting callable capital stock, increasing Canada's total subscription to the Bank's Ordinary Capital to 669,774 shares. As a result, the authorized ordinary capital stock of the Bank was increased by an amount of $4,039.9 million to a total of $104,980.0 million represented by 8,702,335 shares, authorized and subscribed. The paid-in ordinary capital stock of the Bank remained unchanged. The terms and conditions of Canada's subscription to non-voting callable capital stock stipulate that the subscription is on a temporary basis, with Canada required to transfer 25% of the shares back to the Bank on each of the dates that is five, six, seven and eight years from the subscription date. If the Board of Governors approves an increase in the Bank's authorized ordinary capital stock prior to this scheduled transfer of shares, Canada shall have the right to replace its temporary subscription with shares issued under the capital increase, as and when effective.

Capital Increase: As part of the IDB-9, on July 21, 2010, the Board of Governors, agreed to vote on a proposed resolution, that would provide for an increase in the Bank's Ordinary Capital of $70,000 million that would be subscribed to by Bank members in five annual installments, starting in 2011 through 2015. Of this amount, $1,700 million would be in the form of paid-in capital stock, payable in U.S. dollars, and the remainder would constitute callable capital stock. The increase was originally scheduled to enter into effect on October 31, 2011. On October 26, 2011, the Board of Executive Directors approved a resolution extending the deadline for approval of the Ordinary Capital increase and the date of the first subscription installment to January 31, 2012. See the Subsequent and Other Developments section for additional IDB-9 related developments occurring after December 31, 2011.

Borrowings

The Bank raises funds in the international capital markets primarily through the issuance of debt securities. To diversify its sources of funding, the Bank issues its debt securities in various currencies, maturities, formats, and structures to meet the needs of global institutional and retail investors. Under the Agreement, the Bank may borrow only with the approval of the member country in whose markets the debt securities are sold and the member country in whose currency the borrowings are denominated. In addition, the Bank is required to obtain the agreement of each such member country that the proceeds may be exchanged by the Bank for the currency of any other member country without restriction. The Bank's borrowing policy is summarized in **Box 4**.

In 2011, the proceeds from medium- and long-term debt raised directly in financial markets amounted to $6,665 million compared to $11,789 million in 2010. The decrease in borrowings was due, primarily, to lower net loan disbursements of $1,446 million and the positive impact on the Bank's liquidity levels of the conversion of $3,225 million of non-borrowing member currency holdings subject to maintenance of value as well as the dynamic nature of the Bank's liquidity policy. Borrowing operations for 2011 and 2010 are summarized in **Table 8**.

Borrowings raised in any given year are used for general operations, including loan disbursements and refinancing of maturing debt. In 2011, the Bank executed three strategic benchmark global bond issues denominated in United States dollars with five-, seven- and thirty-year maturities for a combined amount of $4,700 million. The Bank also issued its first-ever bond denominated in Norwegian krone. Bonds denominated in borrowing member country currencies in the aggregate amount of $407 million were issued (2010—$733 million), composed of the following currencies: Brazilian reais—$382 million and Chilean pesos—$25 million (2010—Brazilian reais—$707 million, Mexican pesos—$16 million and Colombian pesos—$10 million). In addition, the Bank transacted various bonds denominated in Indian rupees, Indonesian rupiahs, South African rand, New Turkish liras, and United States dollars. New medium- and long-term borrowings by currency for 2011, as compared to 2010, are shown in **Figure 3**.

Borrowings outstanding by currency as of December 31, 2011 and 2010, are shown in **Table 9.**

The Bank may retire its debt earlier than the maturity date. For example, debt may be repurchased to facilitate secondary market liquidity and bonds may be called to reduce the cost of borrowing. During 2011, the Bank early retired $309 million of its borrowings (2010—$506 million).

Box 4: Borrowing Policy

The Bank's policy is to limit the amount of its Net Borrowings to the subscribed callable capital stock of its non-borrowing member countries (the United States, Canada, Japan and the other nonregional members). Net Borrowings is the amount of borrowings (after swaps), plus gross guarantee exposure, less qualified liquid assets (after swaps), which include the special reserve assets. Special reserve assets can only be used for meeting the Bank's obligations on borrowings and guarantees. As of December 31, 2011, Net Borrowings represented 86.3% of the subscribed callable capital stock of the non-borrowing member countries compared to 80.6% in 2010. Accordingly, the unused borrowing capacity at the end of the year amounted to $7,176 million, compared to $10,152 million in 2010.

The objectives of the Bank's borrowing strategy are to secure long-term capital market access, volume and cost effectiveness. The Bank uses derivatives, mostly currency and interest rate swaps, for hedging purposes as part of its liability management to achieve the desired currency composition and interest rate structure as well as to lower its funding costs. The Bank closely monitors and regulates its activities with dealers and counterparties (see "Financial Risk Management—Credit Risk—Commercial Credit Risk" below). The amount and timing of the Bank's borrowings are determined in part by loan disbursements, maturing debt and liquidity levels (see "Liquidity Management" above).

Table 8: SUMMARY OF ANNUAL BORROWING OPERATIONS
For the years ended December 31, 2011 and 2010
(Amounts expressed in millions of United States dollars)

	2011	2010
Total medium- and long- term borrowings[1]	$6,665	$11,789
Average life (years)[2]	6.8	5.3
Number of transactions	40	85
Number of currencies	8	10

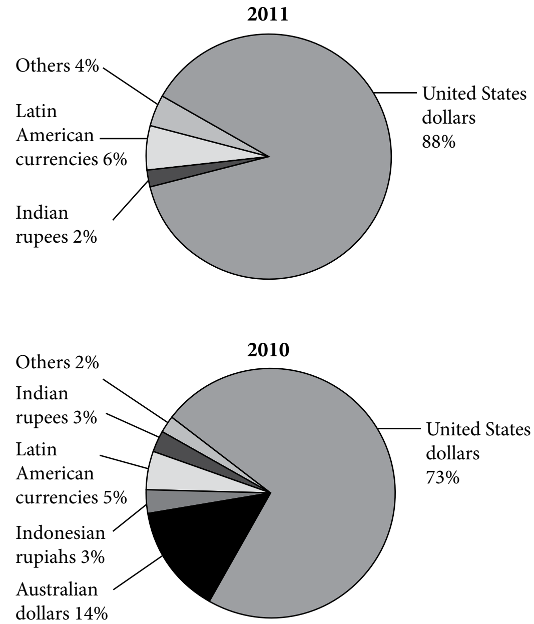
[1] Represents proceeds on a trade date basis.
[2] Average life calculated considering the weighted average probability of exercising call options, as applicable.

Table 9: OUTSTANDING BORROWINGS[(1)]
BY CURRENCY
December 31, 2011 and 2010
(Expressed in millions of United States dollars)

Currency	2011	2010
Australian dollars	$7,503	$8,505
Brazilian reais	1,317	1,145
British pounds sterling	895	887
Canadian dollars	3,657	3,692
Chilean pesos	68	50
Colombian pesos	50	57
Costa Rican colones	51	52
Euro	1,317	1,336
Hong Kong dollars	64	96
Indian rupees	421	306
Indonesian rupiahs	630	674
Japanese yen	975	1,271
Mexican pesos	927	1,123
New Turkish liras	228	257
New Zealand dollars	1,710	1,865
Norwegian krone	84	—
Peruvian new soles	120	116
Russian rubles	36	37
South African rand	212	332
Swiss francs	692	694
United States dollars	38,673	38,629
Total	$59,630	$61,124

[(1)] Medium- and long-term borrowings net of unamortized discounts (before swaps and mark-to-market adjustments).

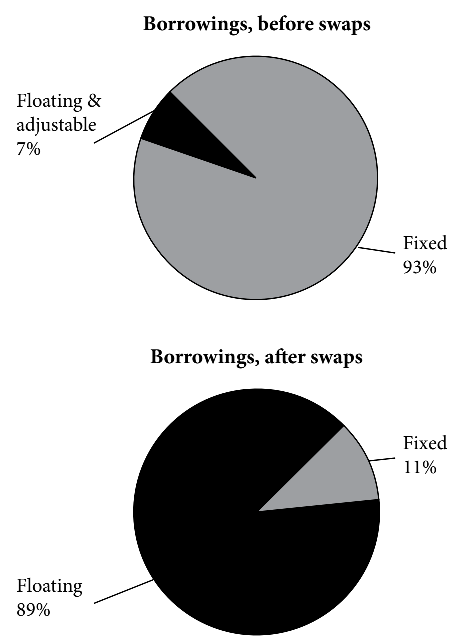
Figure 3: BORROWINGS BY CURRENCY[(1)]
For the years ended December 31, 2011 and 2010



[(1)] Includes medium- and long-term borrowings, excluding swaps, and represents proceeds on a trade date basis.

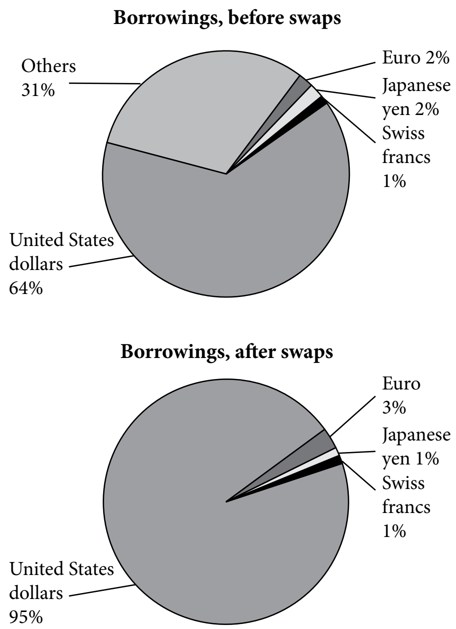
Use of Derivatives: The Bank may enter into currency and interest rate swaps contemporaneously with borrowing transactions in order to convert the proceeds mostly into United States dollars but also into euro, Japanese yen or Swiss francs and fixed or floating rate funding to meet its loan disbursement obligations. In 2011, almost all new fixed rate borrowings were swapped into United States dollars at floating rates and all non-United States dollar borrowings were swapped into United States dollars. **Figures 4** and **5** illustrate the effect of swaps on both the interest rate structure and currency composition of the medium- and long-term borrowing portfolio at December 31, 2011. More detailed information with respect to the Bank's borrowings and related derivatives is contained in Notes I, J, K and L and Appendix I-4 to the financial statements.

Figure 4: EFFECTS OF SWAPS ON INTEREST RATE STRUCTURE OF OUTSTANDING BORROWINGS[(1)]
December 31, 2011



[(1)] Medium- and long-term borrowings only.

Figure 5: EFFECTS OF SWAPS ON CURRENCY COMPOSITION OF OUTSTANDING BORROWINGS(1)
December 31, 2011



(1) Medium- and long-term borrowings only.

RESULTS OF OPERATIONS

Operating Income

Operating Income includes the net interest income on earning assets and the income contribution of the Bank's equity, other loan income, net investment gains, the provision (credit) for loan and guarantee losses and net non-interest expense. **Table 10** shows the breakdown of Operating Income during the last three years.

Table 10: OPERATING INCOME
For the years ended December 31, 2011, 2010 and 2009
(Expressed in millions of United States dollars)

	2011	2010	2009
Loan interest income	$1,683	$1,764	$1,934
Investment interest income	99	178	303
Other interest income	112	7	—
	1,894	1,949	2,237
Less:			
Borrowing expenses	462	550	951
Net interest income	1,432	1,399	1,286
Other loan income	59	66	68
Net investment gains	9	446	528
Other expenses (credits):			
Provision (credit) for loan and guarantee losses	3	24	(21)
Net non-interest expense	661	635	609
Total	664	659	588
Operating Income	$ 836	$1,252	$1,294

Year 2011 versus 2010: The Operating Income for 2011 was $836 million compared to $1,252 million in 2010, a decrease of $416 million. This decrease was mostly due to lower net investment gains of $437 million and higher net non-interest expense of $26 million, which were partially offset by higher net interest income of $33 million and a decrease in the provision for loan and guarantee losses of $21 million.

Year 2010 versus 2009: The Operating Income for 2010 was $1,252 million compared to $1,294 million in 2009, a decrease of $42 million. This decrease was due to lower net investment gains of $82 million, higher net non-interest expense of $26 million, and a provision for loan and guarantee losses of $24 million, compared to a credit of $21 million in 2009, which were partially offset by higher net interest income of $113 million, resulting mainly from an increase in net interest income from loans.

Net Interest Income

Year 2011 versus 2010: The Bank had net interest income of $1,432 million in 2011, compared to $1,399 million in 2010. The increase was mainly due to an increase in the income contribution of the portion of the loan portfolio funded with equity, partially offset by a reduction of net interest income from loans. The lending spread on most of the Bank's loans decreased from 0.95% in 2010 to 0.80% in 2011, which was partially compensated by an increase in the average loan balance of $4,688 million.

The equity duration strategy established in late 2010 resulted in an increase in interest income from the swaps (where the Bank is a variable interest rate payer and a fixed interest rate receiver) of $105 million over the prior year, offsetting the decline in interest income from equity funding variable interest rate loans.

Year 2010 versus 2009: The Bank had net interest income of $1,399 million in 2010, compared to $1,286 million in 2009. The increase of $113 million was substantially due to higher net interest income from loans. The lending spread on most of the Bank's loans increased from an average of 0.63% in 2009 to 0.95% in 2010 while the average loan balance increased by $5,298 million. The effect of this increase was partially offset by a reduction in the return on the portion of the portfolio funded with equity.

Net Investment Gains

Year 2011 versus 2010: The Bank's trading investments portfolio contributed net mark-to-market gains of $9 million, compared to $396 million in 2010, a decrease of $385 million mostly due to the high volatility and general risk aversion in credit markets during the second half of the year.

Year 2010 versus 2009: The Bank's trading investments portfolio contributed net mark-to-market gains of $396 million, compared to $528 million in 2009, a decrease of $132 million mostly due to a slow-down in the recovery of the financial markets. In addition, the Bank recognized net gains of $50 million from the HTM portfolio substantially resulting from the discontinuance of this portfolio in 2010.

The average interest earning asset and interest bearing liability portfolios, after swaps, and the respective returns and costs for 2011, 2010, and 2009 are shown in **Table 11**.

Table 11: ASSET/LIABILITY PORTFOLIOS AND RETURNS/COSTS
For the years ended December 31, 2011, 2010 and 2009
(Amounts expressed in millions of United States dollars)

	2011		2010		2009	
	Average Balance	Return/Cost %	Average Balance	Return/Cost %	Average Balance	Return/Cost %
Loans[(1)]	$63,420	2.65	$58,732	3.01	$53,434	3.62
Liquid investments[(2)(3)]	15,110	0.65	19,631	3.37	19,061	4.29
Total earning assets	$78,530	2.27	$78,363	3.10	$72,495	3.80
Borrowings	$56,794	0.81	$57,555	0.96	$53,372	1.78
Net interest margin[(4)]		1.82		1.79		1.77

(1) Excludes loan fees.
(2) Geometrically-linked time-weighted returns.
(3) Includes gains and losses.
(4) Represents net interest income as a percent of average earning assets.

Net Non-interest Expense

The main components of net non-interest expense are presented in **Table 12.**

Table 12: NET NON-INTEREST EXPENSE
For the years ended December 31, 2011, 2010 and 2009
(Expressed in millions of United States dollars)

	2011	2010	2009
Administrative expenses			
Staff costs	$426	$401	$361
Consultant fees	81	78	70
Operational travel	28	25	24
Realignment expenses	—	1	11
Other expenses	83	79	76
Total gross administrative expenses	618	584	542
Less: Share of Fund for Special Operations	(18)	(11)	(12)
Net administrative expenses	600	573	530
Service fee revenues	(6)	(5)	(5)
Special programs	79	83	94
Other income	(12)	(16)	(10)
Net non-interest expense	$661	$635	$609

Year 2011 versus 2010: Net non-interest expense increased from $635 million in 2010 to $661 million in 2011. The increase is mainly due to higher staff costs of $25 million, of which $17 million relates to higher net pension and postretirement benefit costs.

Year 2010 versus 2009: Net non-interest expense increased from $609 million in 2009 to $635 million in 2010. The increase is substantially due to higher net pension and postretirement benefit costs of $25 million due to the change in the attribution period for medical benefits in 2009, which is being amortized over two years.

FINANCIAL RISK MANAGEMENT

As part of its development banking services, the Bank is exposed to credit risk (loan portfolio or country credit and commercial credit); market risk (interest rate, spread and exchange rate); liquidity risk (funding and liquidation); and operational risk.

Governance

The Bank conducts its operations within a framework of financial and risk management policies, uses only specifically authorized financial instruments and follows a well-defined risk management decision-making process.

The Bank manages its risks in accordance with the Agreement, and such other policies as are approved by its Board of Governors, its Board of Executive Directors and the Finance Committee composed of members of Management. Three risk management units of the Bank—capital adequacy/ALM, treasury risk and credit risk—are combined in the Risk Management Office, which reports directly to the Executive Vice President. The Asset Liability Management Committee (ALCO) is the forum to consider risk and financial management issues in line with best risk management practices. This includes asset/liability management, capital adequacy, financial products (lending, investment, funding, etc.) and planning, treasury risk management, credit risk management, capital markets (i.e., funding and investments), liquidity management, loan management and accounting.

Credit Risk

Credit risk is the potential loss that could result from the default of borrowers (loan portfolio credit risk or country credit risk) or from the default of investment, trading or swap counterparties (commercial credit risk).

Loan Portfolio Credit Risk: Loan portfolio credit risk is the risk that the Bank may not receive repayment of principal and/or interest on one or more of its loans according to the agreed-upon terms. It is directly related to the Bank's core business and is the largest financial risk faced by the Bank. The Bank has multiple sources of protection from loan portfolio credit risk, including an overall lending limitation, a comprehensive capital adequacy framework (designed to ensure that the Bank holds sufficient equity at all times given the quality and concentration of its portfolio), a policy for the treatment of non-performing loans and a policy for the maintenance of a loan loss allowance. The Bank's loan portfolio credit risk is determined by the credit quality of, and exposure to, each borrower.

The credit quality of the sovereign-guaranteed lending portfolio as of December 31, 2011 and 2010, as represented by the long-term foreign currency credit ratings assigned to each borrowing country by the rating agencies (generally, Standard & Poor's), is depicted in **Figure 6**.

Relative to December 31, 2011, **Figure 6** shows that the relative amount of lending exposure to sovereign borrowers rated at investment grade and B+ to B- levels increased from 46% to 56%, and from 26% to 28%, respectively, while the lending exposure to sovereign borrowers in the BB+ to BB- category decreased from 22% to 10%. The relative lending exposure in the non-sovereign-guaranteed category remained unchanged at 6%. No borrower was in selective default. Note that the weighted average credit quality of the Bank's sovereign lending exposure remains at the BB level.

The Bank's exposure reflects the overall size and concentration of the portfolio. Exposure is limited only by the Bank's lending authority; there are no per-country lending limits. Taking into consideration the regional nature of the Bank's operations and the relative sizes of the economies of its borrowing members, the Bank expects to consistently have a concentrated portfolio. As shown in **Figure 7,** from 2010 to 2011, the lending exposure concentration remained basically unchanged. About 67% of the total exposure still is held by the five largest borrowers.

Lending Limitation: The Bank's Agreement limits the total amount of outstanding loans and guarantees to the subscribed capital, plus reserves and surplus, exclusive of income assigned to certain reserves. However, the Bank's lending capacity is also limited by its borrowing policy.

Capital Adequacy Framework: The Bank's capital adequacy framework consists of a policy on capital adequacy and systems that support the determination of capital requirements for credit and market risk in both its lending and treasury operations. In addition, the policy includes capital requirements for operational risk and the exposure from the obligation to fund any changes in the shortfall/surplus of the Bank's

Figure 6: CREDIT QUALITY OF SOVEREIGN-GUARANTEED LEADING EXPOSURE REFLECTED IN RATINGS OF BORROWING MEMBER COUNTRIES December 31, 2011 and 2010

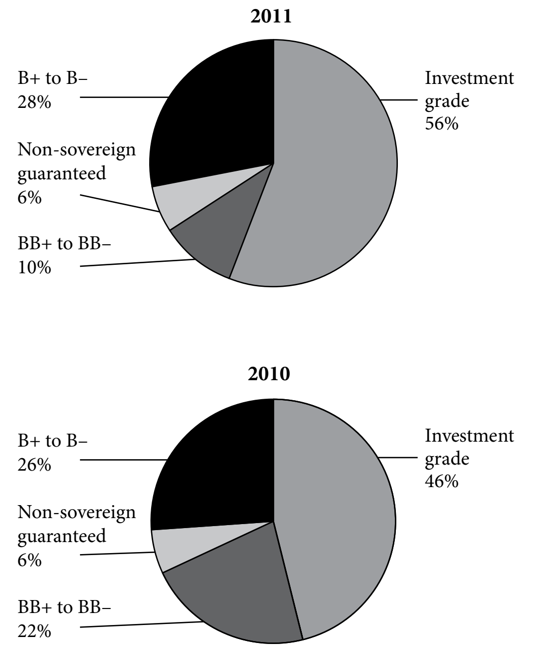
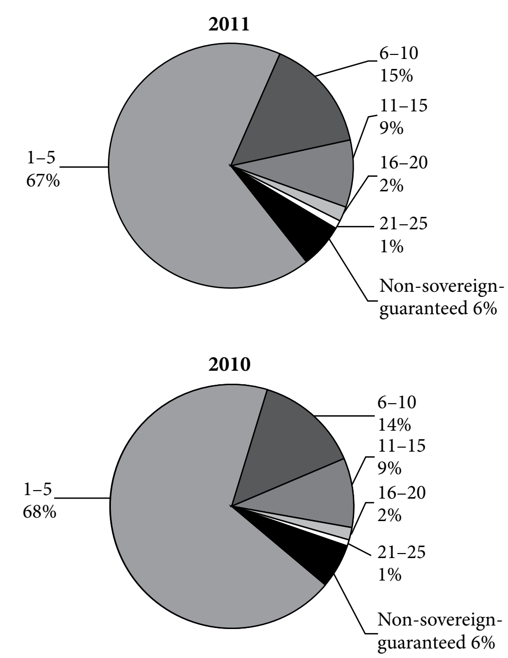


Figure 7: CONCENTRATION OF LENDING EXPOSURE December 31, 2011 and 2010



retirement funds. The policy allows the Bank to measure the inherent risk in its loan portfolio due to the credit quality of its borrowers and the concentration of its loans, and to make flexible adjustments to changing market conditions. As such, specific risk limits in terms of capital requirements for investments and derivatives are included that enables Management to design more efficient funding and investment strategies following the risk tolerance established by the Board of Executive Directors.

Income Management Model: The Bank's Income Management Model (IMM) relates annual decisions on the uses of Ordinary Capital income with the trade-offs associated with the inter-relations of various parameters, such as: the level of loan charges; the annual lending and disbursement programs; the annual administrative expense budget; and annual transfers of income. The IMM provides the Board of the Executive Directors and Management with a methodology to review these parameters in an integrated and simultaneous fashion. The implementation of the IMM is done through the Ordinary Capital Long-Term Financial Projections (LTFP), which is utilized in making annual decisions regarding the budget of the Bank, level of loan charges, the availability of resources for the GRF, other allocations of income, and their impact on the Bank's long-term sustainable lending capacity.

The IMM, requires a minimum level of loan charges for sovereign-guaranteed loans such that the income generated by these charges (adjusting for 90% of the income from the Bank's non-sovereign-guaranteed operations) cover 90% of the Ordinary Capital's administrative expenses.

Non-performing Loans: Except for non-sovereign-guaranteed loans, loan service delays by a borrower in a member country preclude new loan approvals to borrowers in the member country, may lead to the suspension of loan disbursements, may result in the loan being placed in non-accrual status, and may cause the loan to be declared due and payable. The Bank exercises its policy under a graduated approach as summarized in **Table 13**.

If loans made to a member country funded with resources of the FSO or certain other funds owned or administered by the Bank are non-performing, all loans made to or guaranteed by that member government are also considered non-performing. The Bank maintains a continuous dialogue with its borrowers to ensure prompt payment on all of its loans.

In the case of non-sovereign-guaranteed loans, the Private Sector Non-Accrual and Loss Provisioning Committee, chaired by the Chief Risk Officer, determines when the loan is classified in nonaccrual status, which can happen anytime between 30 and 90 days of being overdue or, if special circumstances warrant, at any time prior to the expiry of 30 days.

Loan and Guarantee Loss Allowances: Because of the nature of its borrowers and guarantors, the Bank expects that each of its Ordinary Capital sovereign-guaranteed loans will be repaid. In addition, the Bank has had an essentially fully performing sovereign-guaranteed loan portfolio since its establishment. During the Bank's 52 years of history, only five borrowing countries have been in nonaccrual, for varying times during 1988–1992. The maximum aggregate balance in nonaccrual never exceeded 8% of total loans outstanding, and the Bank received the full principal and interest due on these loans. The Bank maintains allowances for loan and guarantee losses to recognize the probable losses inherent in its loan and guarantee portfolios, primarily related to non-sovereign-guaranteed operations. At December 31, 2011, the Bank had one non-sovereign-guaranteed loan classified as impaired for $129 million (2010—two for $140 million). Pursuant to Bank policy, a provision for loan and guarantee losses of $3 million was recognized during 2011 (2010—$24 million). Total allowances of $175 million were maintained at December 31, 2011 (2010—$172 million). The non-sovereign-guaranteed allowances for loan and guarantee losses were 4.0% of the corresponding combined outstanding portfolios (2010—4.2%).

Commercial Credit Risk: Commercial credit risk is the exposure to losses that could result from the default of one of the Bank's investment, trading or swap counterparties. The main sources of commercial credit risk are the financial

Table 13: TREATMENT OF NON-PERFORMING SOVEREIGN-GUARANTEED LOANS

30 days after loan due date	The Bank suspends disbursements on the loan in arrears and all other loans to the borrower. The Bank informs the guarantor of the arrears by the borrower and requests prompt payment of the amount in arrears. No loan contract with a borrower in the country in question is signed by the Bank and no loan proposal is approved.
120 days after loan due date	The Bank suspends disbursements on all loans to the guarantor and guaranteed by the guarantor if the guarantor fails to pay the amounts due.
180 days after loan due date	The Bank places in nonaccrual status all loans for the country in question of which the government, the central bank or any government entity is a borrower or guarantor, unless it is determined that all payments of amounts in arrears are in process and will be collected in the immediate future. Placement in nonaccrual status implies a reversal of all accrued income to date and no further income accumulation until all pending amounts are received. All Bank missions to the country intended for programming, preparing or processing of loans are suspended.

instruments in which the Bank invests its liquidity. In accordance with its conservative risk policies, the Bank will only invest in high quality debt instruments issued by governments, government agencies, multilateral organizations, financial institutions, and corporate entities, including asset-backed securities. The Bank's process for controlling its commercial credit risk includes: a) specifying authorized investments; b) establishing approved lists of acceptable counterparties, issuers, and dealers; c) defining acceptable credit rating limits; and d) specifying exposure limits and term limits for acceptable counterparties, issuers, and dealers based on their size and creditworthiness.

As part of its regular investment, funding, and asset and liability management activities, the Bank uses derivative instruments, primarily swaps, for hedging purposes. The use of derivatives is limited to authorized dealers and counterparties selected on the basis of conservative risk management policies. The Bank has established exposure limits for each derivative counterparty and has entered into master derivative agreements that contain enforceable closeout netting provisions. These agreements also provide for collateralization in the event that the mark-to-market exposure exceeds certain contractual thresholds. Counterparty exposure against established limits are calculated and monitored on the basis of potential credit exposures modeled throughout the life of each counterparty's portfolio. Simulation is used to model the complex interactions of market risk factors, the dynamics of the portfolio, and the impact of risk mitigation mechanisms such as collateral thresholds and termination triggers, to estimate the potential credit exposure. Monitoring the Bank's exposures and managing such risks are continuous processes. The Bank does not expect nonperformance by any of its swap counterparties.

The Bank treats current credit exposure as the replacement cost of the relevant derivative instrument. This is also referred to as replacement risk or the mark-to-market exposure amount. Mark-to-market exposure is a measure, at a point in time, of the value of a derivative contract in the open market. When the mark-to-market is positive, it indicates that the counterparty owes the Bank and, therefore, creates an exposure for the Bank. When the mark-to-market is negative, the Bank owes the counterparty and does not have replacement risk. When the Bank has more than one derivative transaction outstanding with a derivative counterparty, the "net" mark-to-market exposure represents the netting of the positive and negative exposures with the same counterparty. If this net mark-to-market is negative, the Bank's exposure to the counterparty is considered to be zero.

Table 14 provides details of the estimated current credit exposure on the Bank's investment and swap portfolios, net of collateral, by counterparty rating category. As of December 31, 2011, the credit exposure amounted to $14,121 million,

Table 14: CURRENT CREDIT EXPOSURE, NET OF COLLATERAL HELD, BY COUNTERPARTY RATING CATEGORY
(Amounts expressed in millions of United States dollars)

	December 31, 2011					
	Investments					
Counterparty rating	Governments and Agencies	Banks	ABS and MBS	Net Swap Exposure	Total Exposure on Investments and Swaps	% of Total
AAA[(1)]	$3,756	$ 490	$ 273	$ —	$ 4,519	32.0
AA	4,436	2,587	701	290	8,014	56.8
A	147	246	202	88	683	4.8
BBB	62	—	296	—	358	2.5
BB	—	—	60	—	60	0.4
B	—	—	140	—	140	1.0
CCC	—	—	213	—	213	1.5
CC and below	—	—	134	—	134	1.0
Total	$8,401	$3,323	$2,019	$378	$14,121	100.0

[(1)] Includes $105 million of governments and agencies rated A1+, the highest short-term rating.

	December 31, 2010					
	Investments					
Counterparty rating	Governments and Agencies	Banks	ABS and MBS	Net Swap Exposure	Total Exposure on Investments and Swaps	% of Total
AAA[(1)]	$6,572	$ 972	$1,138	$ —	$ 8,682	50.8
AA	1,787	3,562	801	644	6,794	39.8
A	13	520	140	52	725	4.2
BBB	—	—	235	—	235	1.4
BB	—	—	194	—	194	1.1
B	—	—	92	—	92	0.5
CCC	—	—	239	—	239	1.4
CC and below	—	—	129	—	129	0.8
Total	$8,372	$5,054	$2,968	$696	$17,090	100.0

[(1)] Includes $1,896 million of governments and agencies rated A1+, the highest short-term rating.

compared to $17,090 million as of December 31, 2010. The credit quality of the portfolios continue to be high, as 88.8% of the counterparties are rated AAA and AA, 4.8% are rated A, 2.5% are rated BBB, and 3.9% are rated below BBB, compared to 90.6%, 4.2%, 1.4% and 3.8%, respectively, in 2010. Excluding collateral, the current credit exposure from swaps increased from $4,816 million at December 31, 2010 to $5,050 million at December 31, 2011. This swap credit exposure is offset by collateral (U.S. Treasuries or cash) of $4,653 million (2010—$4,130 million). Total uncollateralized swap exposure at December 31, 2011 was $378 million, compared to $696 million in 2010.

As of December 31, 2011, out of the Bank's total current credit exposure in Europe of $6,718 million, the direct exposure to three Eurozone countries rated A+ or lower (Italy, Portugal, and Spain) was $147 million. The exposure was entirely composed of government agencies. In addition, in the countries specified, the Bank had $401 million of exposure in asset-backed and mortgage-backed securities, generally rated higher than the sovereigns, and $24 million on swaps. All the remaining European current exposure of $6,146 million, regardless of asset class, was in countries rated AA- or higher.

Market Risk

The Bank faces risks that result from market movements, primarily changes in interest and exchange rates, that are mitigated through its integrated asset and liability management framework.

Asset and Liability Management: The objective of asset and liability management is to manage the currency composition, maturity profile and interest rate sensitivity characteristics of the portfolio of liabilities supporting liquidity and each lending product in accordance with the particular requirements for that product and within prescribed risk parameters. The Bank employs derivatives to manage its asset and liability exposures by aligning the characteristics of its debt with the assets it is funding. In addition, the Bank utilizes derivatives to manage the modified duration of its equity within a defined policy band.

The Bank's policy for asset/liability management, among others, provides rules for the active management of equity duration and for limiting the bunching of debt redemptions within any 12-month period. As of December 31, 2011, asset/liability management swaps with a notional amount of $6,143 million (2010—$5,495 million) were outstanding to maintain the equity duration within policy limits.

Interest Rate Risk: The Bank is exposed to two potential sources of interest rate risk. The first is the exposure to changes in the net spread between the rate earned on assets and the cost of borrowings that fund those assets. The second is the exposure to changes in the income earned on the portion of the assets funded with equity.

The Bank mitigates its exposure to net spread changes through either a cost pass-through formulation, calculated on an actual or estimated basis, incorporated in the lending rates charged or hedges of related interest rate exposures. The cost pass-through loans account for 94% of the existing outstanding loan portfolio as of December 31, 2011; the remaining 6% are emergency loans, non-sovereign-guaranteed loans and fixed-rate loans. A small portion of the cost pass-through loans (i.e., the adjustable rate loans) pose some residual interest rate risk given the six-month lag inherent in the lending rate calculation. The Bank funds and invests its liquidity at matching rate structures using specific duration gap constraints, thus avoiding any undue exposure to interest rate risk.

The Bank mitigates its exposure to equity-induced income changes by managing the duration of its equity within a band of four to six years through a combination of assigning equity to fund certain (mostly fixed rate) assets and interest rate swaps that are specifically issued for this purpose. While changes in interest rates will, over the long term, result in corresponding changes in the return on equity, the effect on a single year is relatively small due to the fact that equity is mostly funding fixed rate assets and that for debt-funded assets the interest rate exposure is mostly passed through to the borrowers or hedged through the use of derivative instruments.

Exchange Rate Risk: In order to minimize exchange rate risk in a multicurrency environment, the Bank funds assets in any one currency with, on an after-swap basis, borrowing obligations in the same currency, as prescribed by the Agreement. In addition, the Bank maintains basically all of its equity and equity-funded assets in United States dollars.

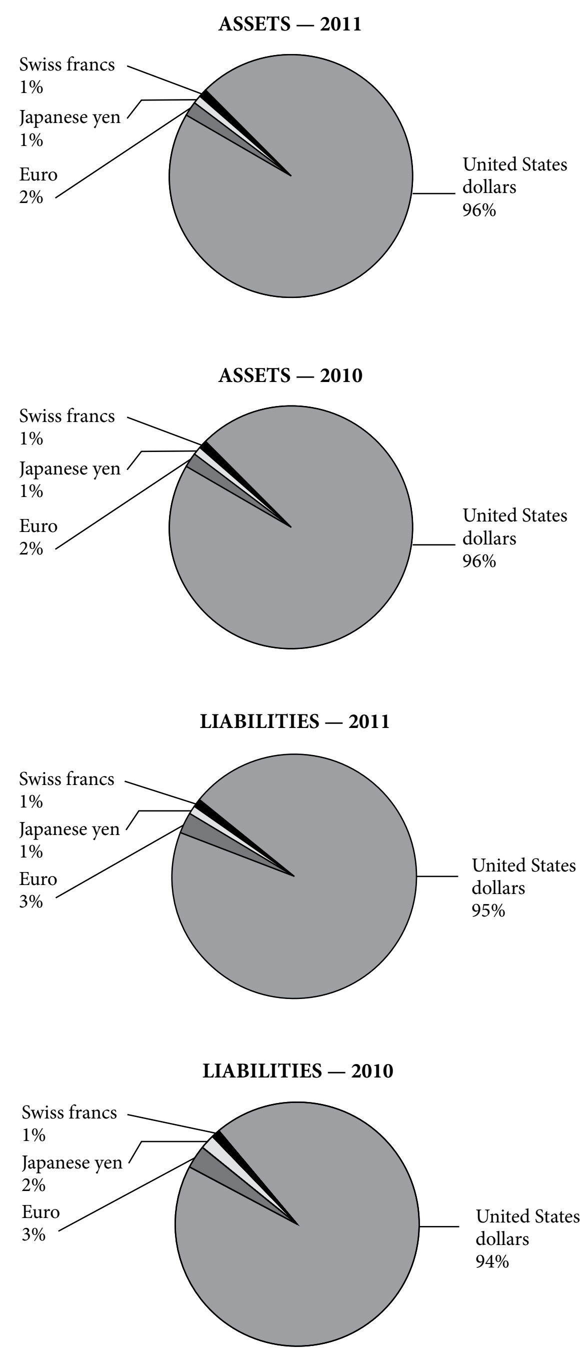
Figure 8 presents the currency composition of the Bank's assets and liabilities (after swaps) at the end of 2011 and 2010.

Liquidity Risk

Liquidity risk arises from the general funding needs of the Bank's activities and in the management of its assets and liabilities. It includes the risk of being unable to fund the portfolio of assets at appropriate maturities and rates (funding risk); the risk of being unable to liquidate a position in a timely manner at a reasonable price (liquidation risk); and the exacerbation of these two risks by having significant portions of a portfolio of assets or liabilities allocated to a specific type of instrument (concentration risk).

The Bank manages liquidity risk through its liquidity policy, asset/liability management policy and its short-term borrowing program. The Bank's liquidity policy determines a minimum amount of liquidity which is designed to allow the Bank to refrain from borrowing for a period of time while continuing to meet its own obligations. The asset and liability management policy of the Bank, in addition to optimizing the allocation of equity and debt to fund the Bank's various assets, limits the amounts of debt refinancing within a given period. Finally, under the short-term borrowing program, discount notes with maturities of less than one year are issued to manage short-term cash flow needs.

Figure 8: CURRENCY COMPOSITION OF ASSETS & LIABILITIES December 31, 2011 and 2010



Operational Risk

Operational risk is the risk arising from inadequate or failed internal processes, people and systems, or from external events, that can cause financial losses or result in reputational damage. These failures may be incurred while executing processes to meet the Bank's objectives; operational risk is inherent in all operations and processes. In addition, operational risk includes fraud and failures in the Bank's execution of its contractual, fiduciary and agency responsibilities.

Within the Bank there are policies and procedures in place covering all significant aspects of operational risk. These include first and foremost the Bank's high standards of business ethics and its established system of internal controls. These are supplemented by the Bank's disaster recovery/contingency planning, the Information Disclosure Policy, client and project integrity due diligence procedures, the procedures for risk management and fiduciary arrangements in projects, and procurement and purchasing policies. Furthermore, the Bank developed and began the implementation of an Operational Risk Framework that governs the coordinated and consistent assessment, mitigation, and reporting of operational risks across the different business units.

Internal Control Over Financial Reporting: The Bank follows the Committee of Sponsoring Organizations of the Treadway Commission Internal Control-Integrated Framework for its financial reporting, and has in place an annual process for Management to report on the effectiveness of the internal control over financial reporting, and for the external auditors to audit and issue an opinion as to the effectiveness of the internal control over financial reporting. The Management report and external auditors' opinion on internal control over financial reporting for 2011 are included in the financial statements.

ADDITIONAL REPORTING AND DISCLOSURE

Basis of Reporting

The financial statements are prepared in accordance with GAAP, which require Management to make estimates and assumptions that affect the reported results (see Note B to the financial statements).

Critical Accounting Policies

The Bank believes that some of the more significant accounting policies it uses to present its financial results in accordance with GAAP involve a relatively high degree of judgment and complexity and relate to matters that are inherently uncertain.

Fair Value of Financial Instruments: The Bank uses fair value measurements to account for the trading investments portfolio, borrowings elected under the fair value option and all derivatives (mostly interest and currency swaps), and for disclosures of financial instruments. Fair values are based on quoted market prices when they are available. Otherwise, fair values are based on prices from external pricing services, where available, solicited broker/dealer prices or prices derived from alternative pricing models, utilizing discounted cash flows. Pricing models generally use inputs from market sources such as interest rate yield curves, currency exchange rates and option volatilities. These inputs have a significant effect on the reported fair values of assets and liabilities and related income and expenses. Management believes its measurements of fair value are reasonable given its processes for obtaining and prioritizing observable inputs (i.e. external prices and parameters) and the consistent application of this approach from period to period.

The interest component of the changes in the fair value of trading securities and related derivatives is presented in Income from Investments-Interest in the Statement of Income and Retained Earnings. The remaining changes in fair value of those securities are presented in Income from Investments-Net gains. The interest component of the changes in fair value of borrowings and lending, borrowing and equity duration derivatives is recorded in Borrowing expenses, Income from loans and Other interest income, respectively. The remaining changes in fair value of these instruments are reported in Net fair value adjustments on non-trading portfolios. See Note R to the financial statements.

Loan and Guarantee Loss Allowances: The Bank maintains allowances for losses on its loan and guarantee portfolios at levels Management believes to be adequate to absorb estimated losses inherent in the total portfolio at the balance sheet date. Setting the level of the allowances requires significant judgment. The use of different estimates or assumptions as well as changes in external factors could produce materially different provisions and allowance levels. Because of the nature of its borrowers and guarantors, the Bank expects that each of its sovereign-guaranteed loans will be repaid. Accordingly, the level of its loan and guarantee loss allowances is relatively small and mainly related to the non-sovereign-guaranteed loan and guarantee portfolios.

Pension and Other Postretirement Benefits: The Bank participates along with the IIC in pension and postretirement benefit plans that cover substantially all of their staff members. All costs, assets and liabilities associated with the plans are allocated between the Bank and the IIC based upon their employees' respective participation in the plans. Costs allocated to the Bank are subsequently shared between the Ordinary Capital and the FSO based on a cost allocation formula approved by the Board of Governors. The underlying actuarial assumptions used to determine the projected benefit obligations and the funded status associated with these plans are based on financial market interest rates, past experience, and Management's best estimate of future benefit changes and economic conditions. For further details, refer to Note S to the financial statements.

External Auditors

General: The external auditors are appointed by the Board of Governors following a competitive bidding process. In 2002, Ernst & Young LLP (E&Y) was appointed as external auditors. Pursuant to an agreement between the Bank and E&Y, the parties extended, on a yearly basis through 2006, E&Y's appointment. In 2007, E&Y won a new competitive bidding and was appointed as the Bank's external auditors for a second five-year period ending in 2011. Management is conducting a competitive bidding process to select a new external auditor for the five-year period 2012-2016, as E&Y will be completing its second and last five-year term in early 2012 in compliance with the Bank's mandatory rotation policy.

Contracted fees for audit services provided to the Bank by E&Y in connection with the 2011 financial statement and internal control audits amount to $1,378,000. In addition, E&Y was paid $131,000 during 2011 for services related to bond issuance. E&Y also provides audit services to trust funds administered by the Bank and to the Bank's staff retirement plans, for which contracted fees related to the 2011 audits are $624,000.

External Auditors' Independence: The Audit Committee is responsible for, among other matters, assisting the Board of Executive Directors in overseeing the external audit function, including ensuring external auditors' independence. In this regard, the Audit Committee is guided by the following key principles:

- The work plan of the external auditors, including audit and audit-related services, must be approved by the Board of Executive Directors, based on the recommendation of the Audit Committee.
- External auditors participation in non-audit services is limited to exceptional audit related services and requires approval of the Board of Directors acting on the recommendation of the Audit Committee.
- The external auditors' engagement and review partners must rotate at least every five years.
- The performance of the external auditors is evaluated annually.
- The external auditors' independence must be confirmed annually by the Audit Committee.
- The external auditors have full access to the Audit Committee and the Board of Executive Directors.

FUND FOR SPECIAL OPERATIONS

General

The FSO was established under the Agreement for the purpose of making loans "on terms and conditions appropriate for dealing with special circumstances arising in specific countries or with respect to specific projects". The amortization periods for loans from the FSO are longer and the interest rates lower than for loans from the Bank's Ordinary Capital.

Under the Agreement, the Ordinary Capital is required at all times and in all respects to be held, used, obligated, invested and otherwise disposed of entirely separate from the FSO. Separate financial statements for the Ordinary Capital operations and the operations of the FSO are required. The Ordinary Capital resources are under no circumstances to be used to discharge losses or liabilities arising from the FSO's operations. Administrative and other expenses pertaining to the operations of the FSO are charged to the FSO (see Note B to the financial statements).

In 2011, the Bank approved 19 parallel loans for a total of $583 million, composed of $181 million and $402 million from the resources of the FSO and the Ordinary Capital, respectively (2010—31 loans totaling $901 million composed of $297 million from the FSO and $604 million from the Ordinary Capital). As of December 31, 2011, FSO outstanding loans amounted to $4,162 million (2010—$4,004 million) and were fully performing. FSO operations generated Income before technical cooperation, debt relief, and Board of Governors approved transfers of $55 million compared to $80 million in 2010.

At December 31, 2011, the FSO's fund balance amounted to $5,429 million (2010—$5,346 million), mostly resulting from subscribed contribution quotas from member governments of the Bank less debt relief provided to the poorest borrowing member countries and Board of Governors approved transfers.

Increase in the Resources of the FSO

As part of the IDB-9, on October 31, 2011, the Board of Governors authorized the increase in the resources of the FSO consisting of an additional $479 million of new contribution quotas to be paid by the Bank members in United States dollars. Member countries could elect to make contributions either in one installment (i.e., their share of the $479 million) or in five equal annual installments of their share of the undiscounted amount of the $479 million, established at $517.3 million, starting in 2011. As of December 31, 2011, instruments of contribution have been received amounting to $425 million, of which $305 million have been paid.

INTERMEDIATE FINANCING FACILITY ACCOUNT

The resources of the IFF are used to defray a portion of the interest due by borrowers on certain loans approved from the Ordinary Capital up to December 31, 2006: a maximum of up to 3.62% per annum (5% per annum for certain loans) of the interest rate due on such loans. The IFF is funded from income earned on its own investments.

IDB GRANT FACILITY

In 2007, the Board of Governors approved the creation of the GRF for the purpose of making grants appropriate for dealing with special circumstances arising in specific countries (currently only Haiti) or with respect to specific projects. The GRF is funded by transfers from the FSO and the Ordinary Capital, and possible direct contributions from donor countries.

As part of the IDB-9, the Board of Governors agreed, in principle and subject to annual approvals by the Board of Governors, to provide $200 million annually in transfers of Ordinary Capital income to the GRF, beginning in 2011 through 2020. In March 2011, the Board of Governors approved the transfer of $200 million (2010—$72 million) of Ordinary Capital income to the GRF. In addition, general reserve transfers from the FSO of $44 million (2010—$364 million) were made, completing the transfers agreed to during the IDB-9 process. Effective December 2011, FSO general reserve transfers to the GRF were discontinued.

Total grants approved for Haiti from the GRF during 2011 amounted to $241 million (2010—$395 million, including undisbursed loans balances from the FSO converted to grants of $144 million).