

Inter-American Development Bank

Ordinary Capital



Management's Discussion and Analysis

and

Condensed Quarterly Financial Statements

March 31, 2015

(Unaudited)

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MANAGEMENT'S DISCUSSION AND ANALYSIS

March 31, 2015

INTRODUCTION

The Inter-American Development Bank (the Bank) is an international institution established in 1959, pursuant to the Agreement Establishing the Inter-American Development Bank (the Agreement). The resources of the Bank consist of the Ordinary Capital, the Fund for Special Operations, the Intermediate Financing Facility Account, and the IDB Grant Facility. All financial information provided in this Management's Discussion and Analysis refers to the Bank's Ordinary Capital.

This document should be read in conjunction with the Bank's Information Statement dated March 13, 2015, which includes the Ordinary Capital financial statements for the year ended December 31, 2014. The Bank undertakes no obligation to update any forward-looking statements.

FINANCIAL STATEMENT REPORTING

The financial statements are prepared in accordance with U.S. generally accepted accounting principles (GAAP). The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported results. Management believes that some of the more significant estimates it uses to present the financial results in accordance with GAAP, for valuation of certain financial instruments carried at fair value, the allowances for loan and guarantee losses, and the valuation of pension and postretirement benefit plan-related liabilities, involve a relatively high degree of judgment and complexity and relate to matters that are inherently uncertain.

Most of the Bank's borrowings and all swaps, including borrowing, lending, and equity duration¹ 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 "Operating Income", which is defined as Income before Net fair value adjustments on non-trading portfolios and foreign currency

transactions and Board of Governors approved transfers². Net fair value adjustments on non-trading portfolios and foreign currency transactions and Board of Governors approved transfers are reported separately in the Statement of Income and Retained Earnings.

ACCOUNTING DEVELOPMENTS

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-9, Revenue from Contracts with Customers (Topic 606), which supersedes the previous revenue recognition requirements and guidance. This new guidance does not apply to financial instruments and guarantees. The ASU is effective for the Bank during the first quarter of 2017 and it is not expected to have a material impact on the Bank's financial condition or results of operations.

In February 2015, the FASB issued ASU No. 2015-2, Consolidation (Topic 810): Amendments to the Consolidation Analysis, which affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. This ASU is effective for the Bank during the first quarter of 2016 and it is not expected to have a material impact on the Bank's financial condition or results of operations.

In April 2015, the FASB issued ASU No. 2015-3, Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. This ASU requires that debt issuance costs related to amortized cost borrowings be presented in the balance sheet as a deduction of the borrowings, consistent with debt discounts. The ASU is effective for the Bank during the first quarter of 2016 and is not expected to have a material impact on the Bank's financial condition or results of operations.

¹ 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.

² References to captions in the attached condensed quarterly 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.

FINANCIAL HIGHLIGHTS

Box 1 presents selected financial data for the three months ended March 31, 2015 and 2014, as well for the year ended December 31, 2014.

Box 1: Selected Financial Data

(Amounts expressed in millions of United States dollars)			
	Three months ended March 31,		Year ended December 31,
	2015	2014	2014
Lending Summary			
Loans and guarantees approved ⁽¹⁾	\$ 825	\$ 738	\$ 12,652
Undisbursed portion of approved loans ⁽²⁾	29,867	28,782	31,601
Gross loan disbursements	2,173	957	9,423
Net loan disbursements ⁽³⁾	1,114	(298)	4,210
Balance Sheet Data			
Cash and investments-net ⁽⁴⁾ , after swaps	\$ 29,196	\$ 25,117	\$ 27,458
Loans outstanding ⁽⁵⁾	75,597	70,393	74,585
Total assets	109,628	100,746	106,299
Borrowings outstanding, after swaps	79,200	70,807	76,686
Callable capital stock (of which, subscribed by United States, Canada, Japan and the other non-regional members)	152,084	139,911	138,901
Equity	76,445	71,105	70,095
	24,015	23,773	23,697
Income Statement Data			
Operating Income ⁽⁶⁾	\$ 187	\$ 236	\$ 652
Net fair value adjustments on non-trading portfolios and foreign currency transactions	81	25	96
Board of Governors approved transfers	(200)	(200)	(200)
Net income	68	61	548
Ratios			
Net borrowings ⁽⁷⁾ as a percentage of callable capital stock subscribed by United States, Canada, Japan and the other non-regional members	66.5%	65.7%	71.2%
Total Equity ⁽⁸⁾ to loans ⁽⁹⁾ ratio	32.3%	34.1%	32.4%
Cash and investments as a percentage of borrowings outstanding, after swaps	36.9%	35.5%	35.8%
⁽¹⁾ Excludes guarantees issued under the Trade Finance Facilitation Program and non-sovereign-guaranteed loan participations.			
⁽²⁾ As of March 31, 2015, the undisbursed portion of approved loans includes \$24,026 million related to signed loans.			
⁽³⁾ Includes gross loan disbursements less principal repayments.			
⁽⁴⁾ Net of Payable for investment securities purchased, Payable for cash collateral received, and Receivable for investment securities sold.			
⁽⁵⁾ Excludes lending swaps in a net liability position of \$447 million as of March 31, 2015 (2014 - \$725 million) and \$568 million as of December 31, 2014.			
⁽⁶⁾ See page 7 for a full discussion of Operating Income under Results of Operations.			
⁽⁷⁾ Borrowings (after swaps) and guarantee exposure, less qualified liquid assets (after swaps).			
⁽⁸⁾ "Total Equity" is defined as Paid-in capital stock, net of Capital subscriptions receivable, less Receivable from members, plus Retained earnings and the allowances for loan and guarantee losses, minus borrowing countries' local currency cash balances, and the cumulative effects of Net fair value adjustments on non-trading portfolios and foreign currency transactions.			
⁽⁹⁾ Includes loans outstanding and guarantee exposure.			

LENDING OPERATIONS: During the first three months of 2015, the Bank approved 11 loans totaling \$825 million compared to 11 loans that totaled \$673 million during the same period in 2014. There were no non-sovereign-guaranteed, non-trade-related guarantees approved (2014 – one for \$65 million) and no trade-related guarantees without sovereign counter-guarantee were issued (2014 – 21 guarantees issued for \$88 million).

The portfolio of non-sovereign-guaranteed loans, including loans to other multilateral development institutions, increased slightly to \$6,030 million compared to \$5,971 million at December 31, 2014. Conversely, the non-sovereign guarantees exposure decreased \$15 million to \$176 million compared to \$191 million at December 31, 2014. As of March 31, 2015 and December 31, 2014, 8.2% of the outstanding loans and guarantees exposure was non-sovereign-guaranteed.

Total allowances for loan and guarantee losses amounted to \$392 million at March 31, 2015 compared to \$373 million at December 31, 2014. The Bank had non-sovereign-guaranteed loans with outstanding balances of \$391 million classified as impaired at March 31, 2015 compared to \$394 million at December 31, 2014. Impaired loans have specific allowances for loan losses amounting to \$210 million at March 31, 2015, compared to \$183 million at December 31, 2014.

For 2015, the Board of Executive Directors approved a lending spread of 0.85%, a credit commission of 0.25% and no supervision and inspection fee, which maintained charges to sovereign-guaranteed financing at the same levels of 2014.

BORROWING OPERATIONS: During the first three months of the year, the Bank issued bonds for a total face amount of \$4,235 million (2014 – \$4,850 million) that generated proceeds of \$4,235 million (2014 – \$4,850 million), representing decreases of \$615 million and \$615 million, respectively, compared to the same period last year. Such decreases are mostly due to lower borrowing needs. The average life of new issues was 7.2 years (2014 – 9.5 years).

During 2015, the Bank continues to be rated Triple-A by the major credit rating agencies.

FINANCIAL RESULTS: Operating income during the first three months of 2015 was \$187 million, compared to \$236 million for the same period last year, a decrease of \$49 million. This decrease was mainly due to a decrease in both other loan income of \$7 million and net investment gains of \$10 million, as well as an increase in the provision for loan and guarantee losses of \$15 million, and in net non-interest expense of \$26 million, partially offset by an increase in net interest income of \$9 million.

During the three months ended March 31, 2015, the trading investments portfolio experienced net mark-to-market gains of \$9 million, compared to \$19 million during the three months ended March 31, 2014. The trading investments portfolio's net interest income, which excludes realized and unrealized investment gains and losses, added income of \$9 million during the first three months of 2015 compared to \$5 million during the same period in 2014.

The provision for loan and guarantee losses was \$19 million compared to \$4 million in the first three months of 2014. The increase was mainly the result of an increase in the specific loan loss allowance due to the deterioration of certain non-sovereign-guaranteed loans classified as impaired.

The Bank had net fair value gains on non-trading portfolios and foreign currency transactions of \$81 million for the three months ended March 31, 2015, compared to gains of \$25 million for the same period in 2014. Net fair value adjustments mostly relate to changes in the fair value of (a) borrowings at fair value due to changes in the Bank's own credit spreads, (b) lending and certain borrowing swaps due to changes in USD interest rates, which are not offset with changes in the value of the related loans and borrowings that are not recorded at fair value, as well as (c) equity duration swaps due to changes in USD interest rates. See Note I to the Condensed Quarterly Financial Statements for further discussion on changes in fair value on non-trading portfolios and foreign currency transactions.

CAPITALIZATION: On February 29, 2012, the IDB-9 entered into effect providing for an increase in the Bank's Ordinary Capital of \$70,000 million, which is being subscribed to by Bank members in five annual installments beginning in 2012. Of this amount, \$1,700 million is paid-in capital stock and the remainder constitutes callable capital stock.

On February 28, 2015, the effective date of the fourth installment, 1,121,078 shares in the amount of \$13,525 million were made effective (\$342 million paid-in; \$13,183 million callable), after Canada's exchange of temporary callable shares.

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 through 2020. In March 2015, the Board of Governors approved the \$200 million transfer corresponding to 2015.

The Bank's equity base plays a critical role in securing its financial objectives. The Total Equity-to-Loans Ratio (TELR) at March 31, 2015 was 32.3% compared to 32.4% at the end of last year (See **Table 1**).

CAPITAL ADEQUACY

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 pension and operational risk.

The capital adequacy 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 adjustments to changing market con-

ditions. 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 appetite established by the Board of Executive Directors. The Bank is operating within its policy limits.

CONDENSED BALANCE SHEET

LOAN PORTFOLIO: 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 addition, the Bank may make loans and guarantees 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 (subject to an exclusion list), provided they meet the Bank's lending criteria.

The Bank also lends to other multilateral development institutions without sovereign guarantee. Non-sovereign-guaranteed operations are currently capped to an amount such that economic capital requirements for such operations do not exceed 20% of the Bank's Total Equity³.

The loan portfolio is the Bank's principal earning asset of which, at March 31, 2015, 92% was sovereign-guaranteed. At March 31, 2015, the total volume of outstanding loans was \$75,597 million, compared with \$74,585 million as of December 31, 2014. The increase in the loan portfolio was mostly due to a higher level of disbursements (\$2,173 million) than loan collections (\$1,059 million), partially offset by negative currency transaction adjustments (\$105 million).

As of March 31, 2015, 8.2% of the outstanding loans and guarantees exposure was non-sovereign-guaranteed, same as it was on December 31, 2014. The non-sovereign-guaranteed loan portfolio, including loans to other multilateral development institutions, totaled \$6,030 million, compared to \$5,971 million at December 31, 2014.

INVESTMENT PORTFOLIO: The Bank's investment portfolio is substantially comprised of highly-rated securities and bank deposits. Its volume is maintained at a level sufficient to ensure that adequate resources are available to meet future cash flow needs. Net investment levels, after swaps, increased \$1,704 million during the first

three months of 2015, mainly resulting from net cash inflows from borrowings (\$2,933 million), collection of capital subscriptions under the IDB-9 (\$165 million), and mark-to-market gains (\$9 million), partially offset by net loan disbursements (\$1,114 million), net cash outflows from operating activities (\$205 million), and negative currency transaction adjustments (\$55 million).

BORROWING PORTFOLIO: The portfolio of borrowings is mostly comprised of medium- and long-term debt raised directly in capital markets. Borrowings outstanding, after swaps, increased \$2,514 million compared with December 31, 2014, primarily due to a higher amount of new borrowings than maturities (\$2,933 million) and the accretion of discount on borrowings (\$54 million), partially offset by the payment of accretion of discount of borrowings and swaps (\$218 million), net decrease in the fair value of borrowings and related swaps (\$207 million), and negative currency transaction adjustments (\$73 million).

EQUITY: Equity at March 31, 2015 was \$24,015 million, an increase of \$318 million from December 31, 2014, reflecting net income of \$68 million, additional paid-in capital made effective and received under the IDB-9 of \$238 million, and the reclassification of net pension actuarial losses of \$12 million from other comprehensive income to net income.

Table 1 presents the composition of the TELR as of March 31, 2015 and December 31, 2014. It shows that the TELR decreased from 32.4% to 32.3% due to the fact that the effect of the increase in loans outstanding and guarantee exposure offset the increase in Total Equity.

³ As of December 31, 2014, the date of the latest quarterly report to the Board of Executive Directors, the economic capital requirements of non-sovereign-guaranteed operations was \$1,702 million, or 7.0% of the Bank's Total Equity.

Table 1: TOTAL EQUITY-TO-LOANS RATIO
(Amounts expressed in millions of United States dollars)

	<u>March 31,</u> <u>2015</u>	<u>December 31,</u> <u>2014</u>
Equity		
Paid-in capital stock	\$ 5,699	\$ 5,357
Capital subscriptions receivable	<u>(188)</u>	<u>(84)</u>
	5,511	5,273
Less: Receivable from members	246	246
Retained earnings:		
General reserve ⁽¹⁾	16,185	16,105
Special reserve ⁽¹⁾	<u>2,565</u>	<u>2,565</u>
	24,015	23,697
Plus:		
Allowances for loan and guarantee losses	392	373
Minus:		
Borrowing countries' local currency cash balances	140	140
Cumulative net fair value adjustments on non-trading portfolios and foreign currency transactions	<u>(244)</u>	<u>(325)</u>
Total Equity	\$ 24,511	\$ 24,255
Loans outstanding and guarantee exposure	\$ 75,833	\$ 74,836
Total Equity-to-Loans Ratio	<u>32.3%</u>	<u>32.4%</u>

⁽¹⁾ Includes Accumulated other comprehensive income.

RESULTS OF OPERATIONS

Table 2 shows a breakdown of Operating Income. For the three months ended March 31, 2015, Operating Income was \$187 million compared to \$236 million for the same period last year, a decrease of \$49 million. This decrease was mainly due to a decrease in other loan income and net investment gains, as well as an increase in both the provision for loan and guarantee losses and in net non-interest expense, partially offset by an increase in net interest income.

The Bank had net interest income of \$346 million during the first three months of 2015, compared to \$337 million for the same period last year.

Net mark-to-market investment gains amounted to \$9 million compared to \$19 million for the same period in 2014.

Net non-interest expense increased \$26 million mainly due to higher net pension and postretirement benefit costs of \$19 million as a result of the amortization of actuarial losses and an increase in the service cost due to the decrease in the rate used to discount the pension liabilities at the end of 2014.

The provision for loan and guarantee losses was \$19 million compared to \$4 million in the first three months of 2014. The increase was mainly the result of an increase in the specific loan loss allowance due to the deterioration of certain non-sovereign-guaranteed loans classified as impaired.

Table 2: OPERATING INCOME
(Expressed in millions of United States dollars)

	Three months ended March 31,		
	2015	2014	2015 vs. 2014
Loan interest income ⁽¹⁾	\$ 414	\$ 411	3
Investment interest income ⁽¹⁾	19	17	2
Other interest income	9	11	(2)
	<u>442</u>	<u>439</u>	<u>3</u>
Less:			
Borrowing expenses ⁽¹⁾	96	102	(6)
Net interest income	<u>346</u>	<u>337</u>	<u>9</u>
Other loan income	20	27	(7)
Net investment gains	9	19	(10)
Other expenses:			
Provision for loan and guarantee losses	19	4	15
Net non-interest expense	<u>169</u>	<u>143</u>	<u>26</u>
Total	<u>188</u>	<u>147</u>	<u>41</u>
Operating Income	<u>\$ 187</u>	<u>\$ 236</u>	<u>\$ (49)</u>

⁽¹⁾ Amounts on an after swap basis.

The average interest-earning asset and interest-bearing liability portfolios, after swaps, and the respective financial returns and costs for the three months ended March

31, 2015 and 2014 and the year ended December 31, 2014 are shown in Table 3.

Table 3: ASSET/LIABILITY PORTFOLIOS AND FINANCIAL RETURNS/COSTS
(Amounts expressed in millions of United States dollars)

	Three months ended		Three months ended		Year ended	
	March 31, 2015		March 31, 2014		December 31, 2014	
	Average	Return/Cost	Average	Return/Cost	Average	Return/Cost
	balance	%	balance	%	balance	%
Loans ⁽¹⁾	\$ 75,528	2.22	\$ 69,870	2.39	\$ 71,280	2.33
Liquid investments ⁽²⁾⁽³⁾	28,564	0.45	22,984	0.77	25,683	0.47
Total earning assets	<u>\$ 104,092</u>	<u>1.73</u>	<u>\$ 92,854</u>	<u>1.99</u>	<u>\$ 96,963</u>	<u>1.84</u>
Borrowings	<u>\$ 78,886</u>	<u>0.49</u>	<u>\$ 69,221</u>	<u>0.60</u>	<u>\$ 72,097</u>	<u>0.55</u>
Net interest margin ⁽⁴⁾		<u>1.35</u>		<u>1.47</u>		<u>1.42</u>

⁽¹⁾ Excludes loan fees.

⁽²⁾ Geometrically-linked time-weighted returns.

⁽³⁾ Includes gains and losses.

⁽⁴⁾ Represents annualized net interest income as a percent of average earning assets.

CORE OPERATING INCOME (NON-GAAP MEASURE):

Although the Bank prepares its financial statements in accordance with U.S. GAAP, management reviews certain results, such as core operating income, on a non-GAAP basis. This measure provides information about the underlying operational performance and trends of the Bank while excluding volatile net investment mark-to-

market gains and losses, non-recurring gains associated with equity duration management and loan prepayments, as well as, the provision for loan and guarantee losses. Table 4 below displays reported Operating Income (GAAP) with the adjustments to arrive at core operating income (Non-GAAP).

Core operating income is a more representative measure of the Bank's operations. Changes in core operating income are driven mainly by changes in the Bank's approved sovereign lending charges and the impact of changes in interest rates on equity funded assets, as well as changes in net non-interest expense.

During 2015, core operating income changes were mostly related to the fluctuations in the net pension and postretirement benefit costs.

Table 4: CORE OPERATING INCOME
(Expressed in millions of United States dollars)

Core Operating Income (Non-GAAP Measure)	Three months ended March 31,		
	2015	2014	2015 vs. 2014
Operating Income (Reported)	\$ 187	\$ 236	\$ (49)
<i>Less:</i>			
Net investment gains	9	19	(10)
<i>Add:</i>			
Provision for loan and guarantee losses	19	4	15
Core operating income	\$ 197	\$ 221	\$ (24)

COMMITMENTS

GUARANTEES: The Bank makes non-trade related guarantees with or without a sovereign counter-guarantee. In addition, the Bank provides credit guarantees without sovereign counter-guarantee for trade-finance transactions under its Trade Finance Facilitation Program. During the three months ended March 31, 2015, there were no non-sovereign-guaranteed, non-trade-related guarantees approved (2014 – one for \$65 million) and no trade-related guarantees issued (2014 – 21 guarantees issued for \$88 million). No guarantees with sovereign counter-guarantee were approved during the first three months of 2015 and 2014.

CONTRACTUAL OBLIGATIONS: The Bank's most significant contractual obligations relate to the repayment of borrowings. As of March 31, 2015, the average maturity of the medium- and long-term borrowing portfolio, after swaps, was 4.11 years with contractual maturity dates through 2044⁴. In addition, the Bank has a number of other obligations to be settled in cash, including leases, undisbursed signed loans (\$24,026 million at March 31, 2015), Short-term borrowings, payable for currency and interest rate swaps, Payable for investment securities purchased, Payable for cash collateral received, Due to IDB Grant Facility, and pension and postretirement benefit obligations.

LIQUIDITY MANAGEMENT

Table 5 shows a breakdown of the trading investments portfolio and related swaps at March 31, 2015 and December 31, 2014, 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 period.

⁴ The maturity structure of medium- and long-term borrowings outstanding at the end of 2014 is presented in Schedule I-4 to the December 31, 2014 financial statements.

Table 5: TRADING INVESTMENTS PORTFOLIO BY MAJOR SECURITY CLASS
(Expressed in millions of United States dollars)

Security Class	March 31, 2015		December 31, 2014	
	Fair Value ⁽¹⁾	Unrealized Gains (Losses)	Fair Value ⁽¹⁾	Unrealized Gains (Losses)
Obligations of the United States Government and its corporations and agencies	\$ 4,958	\$ 7	\$ 5,435	\$ (2)
U.S. Government-sponsored enterprises	204	-	599	-
Obligations of non-U.S. governments	6,169	-	3,959	(2)
Obligations of non-U.S.agencies	8,935	23	9,427	7
Obligations of non-U.S. sub-sovereigns	2,066	9	1,667	5
Obligations of supranationals	1,401	-	1,430	-
Bank obligations	4,888	6	4,054	1
Corporate securities	186	-	423	-
Mortgage-backed securities	300	1	345	22
Asset-backed securities	93	-	110	-
Total trading investments	29,200	46	27,449	31
Currency and interest rate swaps-investments-trading	(35)	(40)	61	-
Total	\$ 29,165	\$ 6	\$ 27,510	\$ 31

⁽¹⁾ Includes accrued interest of \$75 million (2014 - \$54 million) for trading investments and \$(59) million (2014 - \$(34) million) for currency and interest rate swaps, presented in the Condensed Balance Sheet under Accrued interest and other charges.

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 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, agencies, multilaterals, banks, and corporate entities, including asset-backed and mortgage-backed securities.

Table 6 provides details of the estimated current credit exposure on the Bank's investment and swap portfolios, net of collateral held, by counterparty rating category. As of March 31, 2015, the credit exposure amounted to \$29,255 million, compared to \$27,570 million as of December 31, 2014. The credit quality of the portfolios continues to be high, as 81.1% of the counterparties are rated AAA and AA, 10.1% carry the highest short-term

ratings (A1+), 8.4% are rated A, 0.2 % are rated BBB, and 0.2% are rated below BBB, compared to 78.8%, 13.4%, 7.3%, 0.4% and 0.1%, respectively, at December 31, 2014.

As of March 31, 2015, the Bank's total current credit exposure in Europe was \$14,399 million (\$13,223 million at December 31, 2014). There was no direct exposure to Eurozone countries rated BBB or lower as of March 31, 2015 and December 31, 2014. In these countries, the Bank had \$195 million (\$227 million at December 31, 2014) of exposure in asset-backed and mortgage-backed securities, which was generally rated higher than the sovereigns, and \$3 million net swap exposure (none in 2014). The remaining European current credit exposure of \$14,201 million (\$12,996 million at December 31, 2014), regardless of asset class, was in countries rated AA- or higher.

Table 6: Current Credit Exposure, Net of Collateral Held, by Counterparty Rating Category
(Amounts expressed in millions of United States dollars)

March 31, 2015							
Counterparty rating	Investments				Net Swap Exposure	Total Exposure on Investments and Swaps	% of Total
	Governments and Agencies	Banks	Corporates	ABS and MBS			
A1+	\$ 2,863	\$ -	\$ 100	\$ -	\$ -	\$ 2,963	10.1
AAA	8,897	625	-	26	-	9,548	32.6
AA	10,249	3,686	86	123	36	14,180	48.5
A	1,724	577	-	135	19	2,455	8.4
BBB	-	-	-	72	-	72	0.2
BB	-	-	-	20	-	20	0.1
B	-	-	-	-	-	-	0.0
CCC	-	-	-	-	-	-	0.0
CC and below	-	-	-	17	-	17	0.1
Total	<u>\$ 23,733</u>	<u>\$ 4,888</u>	<u>\$ 186</u>	<u>\$ 393</u>	<u>\$ 55</u>	<u>\$ 29,255</u>	<u>100.0</u>

December 31, 2014							
Counterparty rating	Investments				Net Swap Exposure	Total Exposure on Investments and Swaps	% of Total
	Governments and Agencies	Banks	Corporates	ABS and MBS			
A1+	\$ 3,346	\$ -	\$ 358	\$ -	\$ -	\$ 3,704	13.4
AAA	6,918	595	-	36	-	7,549	27.4
AA	11,106	2,828	65	92	87	14,178	51.4
A	1,147	631	-	192	34	2,004	7.3
BBB	-	-	-	118	-	118	0.4
BB	-	-	-	-	-	-	0.0
B	-	-	-	-	-	-	0.0
CCC	-	-	-	-	-	-	0.0
CC and below	-	-	-	17	-	17	0.1
Total	<u>\$ 22,517</u>	<u>\$ 4,054</u>	<u>\$ 423</u>	<u>\$ 455</u>	<u>\$ 121</u>	<u>\$ 27,570</u>	<u>100.0</u>

OTHER DEVELOPMENTS

FINANCIAL REFORM—THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (DFA): 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. The Bank continues to assess the potential impact of the implementation of this financial regulatory reform on its operations as rules continue to become effective and markets adjust. Based on a review of the current regulations and the rules that have become effective to date, the Bank is of the view that effects from the provisions of the DFA apply to the Bank's counterparties and to the Bank's derivatives trading and associated activities, and those effects may include an increase in the Bank's borrowing cost.

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. This legislation seeks to reform aspects of the U.S. health care system and its various provisions are being regulated and become effective over several years. The Bank continues to 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.

INTERNAL POLICY AND OTHER DEVELOPMENTS: The Bank conducts periodic reviews of its financial policies to ensure they remain effective to preserve the Bank's strong financial footing and aligned with industry best practices. As a result of this regular review, the Bank approved changes to enhance the following policies:

The Capital Adequacy Policy (CAP): in October 2014, the Board of Governors reaffirmed the Capital Adequacy Policy Mandate to maintain the Bank's strong financial footing and its Triple-A foreign currency long-term issuer credit rating and expanded the Mandate to include the establishment of capital buffers, specifically to assume financial risks in times of stress, while preserving the Bank's lending capacity. Considering that, Management proposed and the Board of Governors approved, in February 2015, a set of regulations that will govern the implementation of the Bank's Capital Adequacy Policy Mandate. To ensure consistency with the revised CAP framework, the Bank is revising its Income Management Model.

The Liquidity Policy: the changes proposed by Management and adopted by the Board of Executive Directors in March 2015 aim at consolidating the Bank's liquidity position by establishing a longer minimum liquidity coverage horizon and adopting industry best practices in relation to liquidity haircuts. Under the revised policy, the Bank seeks to preserve at least 12 months of projected net cash requirements. The Bank has remained compliant with the required liquidity levels.

Sovereign-Guaranteed Single Borrower Limit: in February 2015, the Board of Executive Directors adopted a policy to introduce an exposure-based single borrower limit for its sovereign-guaranteed credit portfolio. In addition to that, the policy provides for risk-based price differentiation to allow sovereign borrowers to exceed a threshold set below the single borrower limit while contributing to increase the Bank's equity accumulation and partially compensate for additional economic capital requirements. The new limit framework will become effective for the Bank's 2016 lending programming cycle, and although no significant changes of the current portfolio composition are anticipated, the framework is expected to contribute over time to further diversification.

RENEWED VISION OF THE IDB GROUP'S ACTIVITIES WITH THE PRIVATE SECTOR: On March 30, 2015, the Boards of Governors of the IDB and the Inter-American Investment Corporation (IIC) adopted a resolution (the Resolution) that authorizes the transfer of operational and administrative functions and non-financial resources

associated with non-sovereign guaranteed (NSG) activities from the IDB to the IIC.

The Resolution authorizes the capitalization of the IIC in part through annual distributions of income by the IDB to the IIC on behalf of the IDB shareholders. This is intended to be achieved during the period 2018-2025 and for an amount not exceeding \$725 million. These distributions of income are conditional upon annual IDB Board of Governors' approval, who shall take into account the continued maintenance of the IDB's Triple-A long term foreign currency credit rating, the Capital Adequacy Policy, the preservation of the sovereign-guaranteed lending envelope consistent with IDB-9, and the construction of the buffers in accordance with the Capital Adequacy Policy, as well as other applicable financial policies of the Bank.

In addition to the above-mentioned distributions of income, and during the seven-year period starting on January 1, 2016 (or a later date as approved by the IDB Board of Directors), NSG activities will be co-financed by the IDB and the IIC. The Resolution does not impact the IDB's legacy NSG activities and loan balances as of the effective date of the transfer of functions and non-financial resources mentioned above. The implementation of initiatives provided for in the Resolution has no impact on the IDB's equity as reported in the Information Statement dated March 13, 2015, and the IDB will continue to monitor any relevant financial ratios within applicable policy.

FUNDED STATUS OF PENSION AND POSTRETIREMENT BENEFIT PLANS (PLANS): The volatility in the equity and credit markets affects the funded status of the Plans. As of March 31, 2015, increases in pension liabilities due to further decreases in U.S. interest rates, were mostly offset by increases in the Plans' assets, due to both global equity markets and fixed income assets returns. Accordingly, as of March 31, 2015, the Plan's assets represent approximately 90% of the benefit obligations, compared to 91% as of December 31, 2014. The Bank recognizes actuarial gains and losses on its Pension and Postretirement Benefit Plans through comprehensive income at the end of each calendar year, when the pension liabilities are re-measured, as required by GAAP.

**Condensed Quarterly Financial Statements
(Unaudited)**

ORDINARY CAPITAL
INTER-AMERICAN DEVELOPMENT BANK

CONDENSED BALANCE SHEET*(Expressed in millions of United States dollars)*

	March 31, 2015		December 31, 2014	
	(Unaudited)		(Unaudited)	
ASSETS				
Cash and investments				
Cash - Note P	\$ 742		\$ 535	
Investments - Trading - Notes C, G, H and P	<u>29,125</u>	\$ 29,867	<u>27,395</u>	\$ 27,930
Loans outstanding - Notes D, E and P				
Loans outstanding - Notes D, E and P	75,597		74,585	
Allowance for loan losses	<u>(390)</u>	75,207	<u>(370)</u>	74,215
Accrued interest and other charges				
		805		811
Currency and interest rate swaps - Notes G, H, I and P				
Investments - Trading	181		136	
Loans	398		308	
Borrowings	2,341		2,366	
Other	<u>55</u>	2,975	<u>51</u>	2,861
Receivable for investment securities sold				
		300		-
Other assets				
		<u>474</u>		<u>482</u>
Total assets		<u><u>\$ 109,628</u></u>		<u><u>\$ 106,299</u></u>
LIABILITIES AND EQUITY				
Liabilities				
Borrowings - Notes F, G, H, I and P				
Short-term	\$ 701		\$ 675	
Medium- and long-term:				
Measured at fair value	48,181		48,881	
Measured at amortized cost	<u>30,341</u>	\$ 79,223	<u>27,753</u>	\$ 77,309
Currency and interest rate swaps - Notes G, H, I and P				
Investments - Trading	157		41	
Loans	845		876	
Borrowings	2,318		1,743	
Others	<u>3</u>	3,323	<u>9</u>	2,669
Payable for investment securities purchased		424		169
Payable for cash collateral received		571		398
Due to IDB Grant Facility - Note J		687		501
Accrued interest on borrowings		411		492
Liabilities under retirement benefit plans - Note L		517		515
Undisbursed special programs		234		244
Other liabilities		<u>223</u>		<u>305</u>
Total liabilities		85,613		82,602
Equity				
Capital stock - Note K				
Subscribed 13,079,417 shares (2014 - 11,958,339 shares)	157,783		144,258	
Less callable portion	<u>(152,084)</u>		<u>(138,901)</u>	
Paid-in capital stock	5,699		5,357	
Capital subscriptions receivable	(188)		(84)	
Receivable from members	(246)		(246)	
Retained earnings	18,315		18,247	
Accumulated other comprehensive income	<u>435</u>	24,015	<u>423</u>	23,697
Total liabilities and equity		<u><u>\$ 109,628</u></u>		<u><u>\$ 106,299</u></u>

The accompanying notes are an integral part of these condensed quarterly financial statements.

ORDINARY CAPITAL
INTER-AMERICAN DEVELOPMENT BANK

CONDENSED STATEMENT OF INCOME AND RETAINED EARNINGS

(Expressed in millions of United States dollars)

	Three months ended March 31,	
	2015	2014
	(Unaudited)	
Income		
Loans, after swaps - Notes D and G	\$ 434	\$ 438
Investments - Notes C and G		
Interest	19	17
Net gains	9	19
Other interest income - Notes G and I	9	11
Other	8	8
Total income	<u>479</u>	<u>493</u>
Expenses		
Borrowing expenses, after swaps - Notes F, G and H	96	102
Provision for loan and guarantee losses - Note E	19	4
Administrative expenses	168	140
Special programs	9	11
Total expenses	<u>292</u>	<u>257</u>
Income before Net fair value adjustments on non-trading portfolios and foreign currency transactions and Board of Governors approved transfers	187	236
Net fair value adjustments on non-trading portfolios and foreign currency transactions - Notes F, G and I	81	25
Board of Governors approved transfers - Note J	(200)	(200)
Net income	68	61
Retained earnings, beginning of period	18,247	17,699
Retained earnings, end of period	\$ 18,315	\$ 17,760

CONDENSED STATEMENT OF COMPREHENSIVE INCOME

(Expressed in millions of United States dollars)

	Three months ended March 31,	
	2015	2014
	(Unaudited)	
Net income	\$ 68	\$ 61
Other comprehensive income		
Reclassification to income - amortization of net actuarial losses and prior service credit on retirement benefits plans - Note L	12	-
Total other comprehensive income	<u>12</u>	<u>-</u>
Comprehensive income	\$ 80	\$ 61

The accompanying notes are an integral part of these condensed quarterly financial statements.

ORDINARY CAPITAL
INTER-AMERICAN DEVELOPMENT BANK

CONDENSED STATEMENT OF CASH FLOWS

(Expressed in millions of United States dollars)

	Three months ended	
	March 31,	
	2015	2014
	(Unaudited)	
Cash flows from lending and investing activities		
Lending:		
Loan disbursements	\$ (2,173)	\$ (957)
Loan collections	<u>1,059</u>	<u>1,255</u>
Net cash provided by (used in) lending activities	<u>(1,114)</u>	<u>298</u>
Miscellaneous assets and liabilities	<u>4</u>	<u>(32)</u>
Net cash provided by (used in) lending and investing activities	<u>(1,110)</u>	<u>266</u>
Cash flows from financing activities		
Medium- and long-term borrowings:		
Proceeds from issuance	4,235	4,850
Repayments	(1,328)	(1,472)
Short-term borrowings, net	26	11
Cash collateral received	173	(26)
Collections of capital subscriptions	165	77
Payments of maintenance of value to members	(2)	-
Net cash provided by financing activities	<u>3,269</u>	<u>3,440</u>
Cash flows from operating activities		
Gross purchases of trading investments	(11,164)	(13,040)
Gross proceeds from sale or maturity of trading investments	9,410	9,103
Loan income collections, after swaps	238	352
Interest and other costs of borrowings, after swaps	(284)	(55)
Income from investments	13	40
Other interest income	10	11
Other income	8	8
Administrative expenses	(157)	(151)
Special programs	(19)	(17)
Transfers to the IDB Grant Facility	(14)	(22)
Net cash used in operating activities	<u>(1,959)</u>	<u>(3,771)</u>
Effect of exchange rate fluctuations on Cash	<u>7</u>	<u>1</u>
Net increase (decrease) in Cash	<u>207</u>	<u>(64)</u>
Cash, beginning of period	<u>535</u>	<u>421</u>
Cash, end of period	<u>\$ 742</u>	<u>\$ 357</u>

The accompanying notes are an integral part of these condensed quarterly financial statements.

ORDINARY CAPITAL
INTER-AMERICAN DEVELOPMENT BANK

**NOTES TO THE CONDENSED QUARTERLY
FINANCIAL STATEMENTS (UNAUDITED)**

NOTE A – FINANCIAL INFORMATION

The primary activities of the Inter-American Development Bank (Bank) are conducted through the Ordinary Capital, which is supplemented by the Fund for Special Operations (FSO), the Intermediate Financing Facility Account, and the IDB Grant Facility. Unless otherwise indicated, all financial information provided in these Condensed Quarterly Financial Statements refers to the Ordinary Capital. The Condensed Quarterly Financial Statements should be read in conjunction with the December 31, 2014 financial statements and notes therein included in the Bank's Information Statement dated March 13, 2015. Management believes that the Condensed Quarterly Financial Statements reflect all adjustments necessary for a fair presentation of the Ordinary Capital's financial position and results of operations in accordance with U.S. generally accepted accounting principles (GAAP). The results of operations for the first three months of the current year are not necessarily indicative of the results that may be expected for the full year.

**NOTE B – SUMMARY OF SIGNIFICANT
ACCOUNTING POLICIES**

The financial statements are prepared in conformity with GAAP. The preparation of such financial statements requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from these estimates. Areas in which significant estimates have been made include, but are not limited to, the valuation of certain financial instruments carried at fair value, the allowance for loan and guarantee losses, and the valuation of the pension and postretirement benefit plan-related liabilities.

New accounting pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-9, Revenue from Contracts with Customers (Topic 606), which supersedes the previous revenue recognition requirements and guidance. This new guidance does not apply to financial instruments and guarantees. The ASU is effective for the Bank during the first quarter of 2017

and it is not expected to have a material impact on the Bank's financial condition or results of operations.

In February 2015, the FASB issued ASU No. 2015-2, Consolidation (Topic 810): Amendments to the Consolidation Analysis, which affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. This ASU is effective for the Bank during the first quarter of 2016 and it is not expected to have a material impact on the Bank's financial condition or results of operations.

In April 2015, the FASB issued ASU No. 2015-3, Interest—Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. This ASU requires that debt issuance costs related to amortized cost borrowings be presented in the balance sheet as a deduction of the borrowings, consistent with debt discounts. The ASU is effective for the Bank during the first quarter of 2016 and it is not expected to have a material impact on the Bank's financial condition or results of operations.

NOTE C – INVESTMENTS

As part of its overall portfolio management strategy, the Bank invests in sovereign and sub-sovereign governments, agency, supranational, bank and corporate entities, including asset-backed and mortgage-backed securities, and related financial derivative instruments, primarily currency and interest rate swaps.

For obligations issued or unconditionally guaranteed by sovereign and sub-sovereign governments and agencies, including asset-backed and mortgage-backed securities, the Bank's policy is to invest in such obligations with a minimum credit quality equivalent to AA-. Obligations issued by supranational organizations require a credit quality equivalent to a AAA rating. In addition, the Bank invests in senior bank obligations with a minimum credit quality equivalent to A+, and in corporate entities with a minimum credit quality equivalent to a AA- rating (private asset-backed and mortgage-backed securities require a credit quality equivalent to a AAA rating). The Bank also invests in short-term securities of the eligible investment asset classes mentioned above, provided that they carry only the highest short-term credit ratings.

Net unrealized gains of \$6 million on trading portfolio instruments held at March 31, 2015, compared to \$16 million at March 31, 2014, were included in Income from Investments - Net gains.

A summary of the trading portfolio instruments at March 31, 2015 and December 31, 2014 is shown in Note H – Fair Value Measurements.

NOTE D – LOANS AND GUARANTEES

The FFF is the only financial product platform for approval of all regular Ordinary Capital sovereign guaranteed loans. With 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 allows 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. FFF loans have an interest rate based on LIBOR plus a funding margin, as well as the Bank's spread.

LOAN CHARGES: For 2015, the Board of Executive Directors approved a lending spread of 0.85%, a credit commission of 0.25%, and no supervision and inspection fee. These charges apply to substantially all sovereign-guaranteed loans, comprising approximately 92% of the loan portfolio, and are subject to annual review and approval by the Board of Executive Directors.

GUARANTEES: During the three months ended March 31, 2015, there were no non-sovereign guaranteed, non-trade-related guarantees approved (2014 – one approved for \$65 million). No guarantees with sovereign counter-guarantee were approved during the first three months of 2015 and 2014. As of March 31, 2015 and December 31, 2014, the Bank had approved, net of cancellations and maturities, non-trade-related guarantees without sovereign counter-guarantees of \$859 million, and guarantees with sovereign counter-guarantee of \$60 million, respectively.

Under its non-sovereign-guaranteed Trade Finance Facilitation Program (TFFP), in addition to direct loans, the Bank provides credit guarantees on short-term trade related transactions. The TFFP authorizes lines of credit in support of approved issuing banks and non-bank financial institutions, with an aggregate program limit of up to \$1,000 million outstanding at any time. During the first three months of the year, the Bank issued no guarantees under this program (2014 – 21 guarantees for \$88 million).

Guarantees outstanding represent the maximum potential undiscounted future payments that the Bank could be required to make under its guarantees. At March 31, 2015, guarantees of \$236 million (\$251 million at December 31, 2014), including \$11 million issued under the TFFP (\$16 million at December 31, 2014), were outstanding and subject to call. An amount of \$16 million (\$18 million at December 31, 2014) of guarantees outstanding has been reinsured. Outstanding guarantees

have remaining maturities ranging from 4 months to 11 years, except for trade related guarantees that have maturities of up to three years.

At March 31, 2015 and December 31, 2014, the Bank's exposure on guarantees without sovereign counter-guarantee amounted to \$176 million and \$191 million, respectively, and was classified as follows (in millions):

Internal Credit Risk Classification (RC)	March 31, 2015	December 31, 2014	S&P/Moody's Rating Equivalent
RC1	\$ 123	\$ 128	BBB/Baa3 or higher
RC2	1	1	BB+/Ba1
RC3	18	24	BB/Ba2
RC4	27	29	BB-/Ba3
RC5	7	8	B+/B1
RC6	-	-	B/B2
RC7	-	1	B-/B3
RC8	-	-	CCC-D / Caa-D
Total	<u>\$ 176</u>	<u>\$ 191</u>	

The Bank's exposure on guarantees with sovereign counter-guarantee amounted to \$60 million at March 31, 2015 and December 31, 2014 and were rated BBB+.

NOTE E – CREDIT RISK FROM LOAN PORTFOLIO

The 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. The Bank's loan portfolio credit risk is determined by the credit quality of, and exposure to, each borrower.

The Bank manages two principal sources of credit risk from its loan activities: sovereign-guaranteed loans and non-sovereign-guaranteed loans. Approximately 92% of the loans are sovereign-guaranteed.

SOVEREIGN-GUARANTEED LOANS: When the Bank lends to public sector borrowers, it generally requires a full sovereign guarantee or the equivalent from the borrowing member state. In extending credit to sovereign entities, the Bank is exposed to country risk which includes potential losses arising from a country's inability or unwillingness to service its obligations to the Bank.

For the Bank, the likelihood of experiencing an event of default in its sovereign-guaranteed loan portfolio is different than commercial lenders. The Bank does not renegotiate or reschedule its sovereign-guaranteed loans and historically has always received full principal and interest due at the resolution of a sovereign event of default. Accordingly, the probabilities of default to the Bank assigned to each country are adjusted to reflect the Bank's expectation of full recovery of all its sovereign-guaranteed loans. However, even with full repayment of principal and interest at the end of the event of default, the Bank suffers an economic loss from not charging

interest on overdue interest while the event of default lasts.

The credit quality of the sovereign-guaranteed loan portfolio as of March 31, 2015 and December 31, 2014, as represented by the long-term foreign credit rating assigned to each borrower country by Standard & Poor's (S&P), is as follows (in millions):

Country Ratings	March 31, 2015	December 31, 2014
AA+ to AA-	\$ 450	\$ 479
A+ to A-	620	628
BBB+ to BBB-	39,967	39,831
BB+ to BB-	4,749	4,762
B+ to B-	10,107	9,115
CCC+ to CCC-	2,528	2,496
SD	11,146	11,303
Total	<u>\$ 69,567</u>	<u>\$ 68,614</u>

The ratings presented above have been updated as of March 31, 2015 and December 31, 2014, respectively.

NON-SOVEREIGN-GUARANTEED LOANS: The Bank does not benefit from sovereign guarantees when lending to non-sovereign-guaranteed borrowers. Risk and performance for these loans are evaluated by scoring the individual risk factors under each of the borrower and transaction dimensions. The major risk factors evaluated at the transaction level consider the priority that the loans made by the Bank have in relation to other obligations of the borrower; the type of security collateralizing the agreement; and the nature and extent of the covenants that the borrower must comply. The major credit risk factors considered at the borrower level of a project finance operation may be grouped into three major categories: political risk, commercial or project risk, and financial risk.

The transfer and convertibility rating assigned by S&P to the country where the borrower/project is incorporated is considered a proxy of the impact of the macro-economic environment on the ability of the borrower to reimburse the Bank and as such, it is currently considered a ceiling for the transaction dimension risk rating. The credit quality of the non-sovereign-guaranteed loan portfolio as of March 31, 2015 and December 31, 2014, excluding loans to other multilateral development institutions, as represented by the internal credit risk classification, is as follows (in millions):

Risk Classification (RC)	March 31, 2015	December 31, 2014	S&P/Moody's Rating Equivalent
RC1	\$ 782	\$ 792	BBB / Baa3 or higher
RC2	900	927	BB+ / Ba1
RC3	1,410	1,415	BB / Ba2
RC4	1,100	1,037	BB- / Ba3
RC5	779	721	B+ / B1
RC6	266	263	B / B2
RC7	209	210	B- / B3
RC8	454	472	CCC-D / Caa-D
Total	<u>\$ 5,900</u>	<u>\$ 5,837</u>	

In addition, as of March 31, 2015, the Bank has loans to other multilateral development institutions of \$130 million (\$134 million at December 31, 2014), with ratings ranging from AA to A.

Past due and Non-accrual loans

As of March 31, 2015, non-sovereign-guaranteed loans ninety or more days past due amounted to \$176 million (\$177 million at December 31, 2014). Non-sovereign guaranteed loans with outstanding balances of \$391 million (\$394 million at December 31, 2014) were on non-accrual status. There were no sovereign-guaranteed loans past due or in non-accrual status as of March 31, 2015 and December 31, 2014.

Impaired loans

The Bank's recorded investment in non-sovereign-guaranteed loans classified as impaired was \$391 million at March 31, 2015 (\$394 million at December 31, 2014). All impaired loans have specific allowances for loan losses of \$210 million (\$183 million at December 31, 2014).

A summary of financial information related to impaired loans affecting the results of operations for the three months ended March 31, 2015 and 2014 (in millions) is as follows:

	Three months ended	
	March 31, 2015	2014
Average recorded investment during the period	\$ 392	\$ 307
Loan income recognized	2	4
Loan income that would have been recognized on an accrual basis during the period	5	5

Allowance for Loan and Guarantee Losses

SOVEREIGN-GUARANTEED PORTFOLIO: A collective evaluation of collectibility is performed for sovereign-guaranteed loans and guarantees. Historically, virtually all the sovereign-guaranteed loan portfolio has been fully performing. The Bank does not reschedule sovereign-guaranteed loans and has not written-off, and has no expectation of writing off, such loans. However, in the past the Bank has experienced delays in the receipt of

debt service payments, sometimes for more than six months. Since the Bank does not charge interest on missed interest payments for these loans, such delay in debt service payments is viewed as a potential impairment as the timing of the cash flows may not be met in accordance with the terms of the loan contract.

NON-SOVEREIGN-GUARANTEED PORTFOLIO: For non-sovereign guaranteed loans and guarantees, a collective loss allowance is determined based on the Bank's internal credit risk classification system discussed above and it is accomplished in two steps: (i) obtain the probabilities of default to be used for individual loans and guarantees. The Bank's internal credit ratings are mapped to the credit ratings used by external credit rating agencies, essentially mapping the probabilities of default related to each of the Bank's credit rating categories to probabilities of default published by the external credit agencies. Transitions of debt instruments from various risk categories to impairment/default status are modeled utilizing worldwide non-sovereign data gathered from the documented experience of rated non-sovereign-guaranteed debt issuances of similar risk level; (ii) an estimated loss (loss given default) rate is generally determined based upon Management's best estimate of incurred losses, which takes into account the Bank's specific experience and external benchmarks; or by the loss given default ratios calculated by external credit agencies for similar type of exposures in areas where the Bank has limited specific experience, as it is the case for certain financing products such as subordinated exposures for which the Bank currently uses Moody's estimates. Based upon (i) the probability of default rate for each risk category, (ii) the amount of credit exposure in each of these categories and (iii) the loss given default ratio, the required level of the collective loss allowance is determined.

The changes in the allowance for loan and guarantee losses for the period ended March 31, 2015 and the year ended December 31, 2014, were as follows (in millions):

	<u>March 31, 2015</u>	<u>December 31, 2014</u>
Balance, beginning of year	\$ 373	\$ 255
Provision for loan and guarantee losses	19	118
Balance, end of period	<u>\$ 392</u>	<u>\$ 373</u>
Composed of:		
Allowance for loan losses	\$ 390	\$ 370
Allowance for guarantee losses ⁽¹⁾	2	3
Total	<u>\$ 392</u>	<u>\$ 373</u>

⁽¹⁾ The allowance for guarantee losses is included in Other liabilities in the Condensed Balance Sheet.

The changes in the allowance for loan and guarantee losses by portfolio for the period ended March 31, 2015

and the year ended December 31, 2014, were as follows (in millions):

Sovereign-guaranteed portfolio:		
	<u>March 31, 2015</u>	<u>December 31, 2014</u>
Collective allowance		
Balance, beginning of year	\$ 14	\$ 5
Provision (credit) for loan and guarantee losses	(10)	9
Balance, end of period	<u>\$ 4</u>	<u>\$ 14</u>
Non-sovereign-guaranteed portfolio:		
	<u>March 31, 2015</u>	<u>December 31, 2014</u>
Specific allowance		
Balance, beginning of year	\$ 183	\$ 88
Provision for loan and guarantee losses	27	95
Balance, end of period	<u>\$ 210</u>	<u>\$ 183</u>
	<u>March 31, 2015</u>	<u>December 31, 2014</u>
Collective allowance		
Balance, beginning of year	\$ 176	\$ 162
Provision for loan and guarantee losses	2	14
Balance, end of period	<u>\$ 178</u>	<u>\$ 176</u>

During the first three months of 2015, there were no significant changes to the Bank's policy with respect to the allowance for loan and guarantee losses from the prior year. Except for the impaired loans on the non-sovereign-guaranteed portfolio, all loans and guarantees have been collectively evaluated for impairment.

Troubled debt restructurings

A modification of a non-sovereign-guaranteed loan is considered a troubled debt restructuring when the borrower is experiencing financial difficulty and the Bank has granted a concession to the borrower.

A restructured loan is considered impaired when it does not perform in accordance with the contractual terms of the restructuring agreement. A loan restructured under a troubled debt restructuring is considered impaired, until its extinguishment, but it is not disclosed as such after the year it was restructured, if the restructuring agreement specifies an interest rate equal to or greater than the rate that the Bank was willing to accept at the time of the restructuring for a new loan with comparable risk, and the loan is not impaired based on the terms specified in the restructuring agreement.

During the first three months of 2015, there were no troubled debt restructurings or payment defaults associated with previous troubled debt restructurings.

NOTE F – FAIR VALUE OPTION

The Bank has elected the fair value option under GAAP for most of its medium- and long-term debt, to reduce the income volatility resulting from the previous accounting asymmetry of marking to market borrowing swaps through income while recognizing all borrowings at

amortized cost. Individual borrowings are elected for fair value reporting on an instrument by instrument basis, and the election is made upon the initial recognition of a borrowing and may not be revoked once an election is made. However, income volatility still results from the changes in fair value of the Bank's 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. In order to address this income volatility, the Bank takes into consideration all of its non-trading financial instruments (i.e., borrowings, loans and derivatives) in determining its fair value option elections for borrowings.

The changes in fair value for borrowings elected under the fair value option have been recorded in the Condensed Statement of Income and Retained Earnings for the three months ended March 31, 2015 and 2014, as follows (in millions):

	Three months ended	
	March 31,	
	2015	2014
Borrowing expenses, after swaps	\$ (356)	\$ (384)
Net fair value adjustments on non-trading portfolios and foreign currency transactions	902	(364)
Total changes in fair value included in Net income	<u>\$ 546</u>	<u>\$ (748)</u>

The difference between the fair value amount and the unpaid principal outstanding of borrowings measured at fair value as of March 31, 2015 and December 31, 2014, was as follows (in millions):

	March 31,	December 31,
	2015	2014
Fair value	\$ 48,477 ⁽¹⁾	\$ 49,245 ⁽¹⁾
Unpaid principal outstanding	46,223	47,199
Fair value over unpaid principal outstanding	<u>\$ 2,254</u>	<u>\$ 2,046</u>

⁽¹⁾ Includes accrued interest of \$296 million at March 31, 2015 and \$364 million at December 31, 2014.

NOTE G – DERIVATIVES

RISK MANAGEMENT STRATEGY AND USE OF DERIVATIVES: The Bank faces risks that result from market movements, primarily changes in interest and exchange rates, which are mitigated through its integrated asset and liability management framework. The objective of the asset and liability management framework is to align the currency composition, maturity profile and interest rate sensitivity characteristics of the assets and liabilities for each liquidity and lending product portfolio in accordance with the particular requirements for that product and within prescribed risk parameters. When necessary, the Bank employs derivatives to achieve this alignment. These instruments, mostly currency and inter-

est rate swaps, are used primarily for economic hedging purposes, but are not designated as hedging instruments for accounting purposes.

A significant number of the current borrowing operations include swaps to economically hedge a specific underlying liability, producing the funding required (i.e., the appropriate currency and interest rate type). The Bank also uses lending swaps to economically hedge fixed-rate, fixed-base cost rate and local currency loans, and investment swaps that hedge a particular underlying investment security and produce the appropriate vehicle in which to invest existing cash. In addition, the Bank utilizes interest rate swaps to maintain the duration of its equity within a prescribed policy band of 4 to 6 years.

ACCOUNTING FOR DERIVATIVES: All derivatives are recognized in the Condensed Balance Sheet at their fair value, are classified as either assets or liabilities, depending on the nature (receivable or payable) of their net fair value amount, and are not designated as hedging instruments.

The interest component of investment, lending, borrowing, and equity duration derivatives is recorded in Income from Investments - Interest, Income from Loans, after swaps, Borrowing expenses, after swaps, and Other interest income, respectively, with the remaining changes in the fair value included in Income from Investments - Net gains for investment derivatives and in Net fair value adjustments on non-trading portfolios and foreign currency transactions for lending, borrowing and equity duration derivative instruments.

Realized gains and losses on non-trading derivatives are reclassified from Net fair value adjustments on non-trading portfolios and foreign currency transactions to Income from loans, after swaps, Borrowing expenses, after swaps, and Other interest income, respectively, upon termination of a swap.

The Bank occasionally issues debt securities that contain embedded derivatives. These securities are carried at fair value.

FINANCIAL STATEMENTS PRESENTATION: The Bank's derivative instruments as of March 31, 2015 and December 31, 2014, and their related gains and losses for the three months ended March 31, 2015 and 2014, are presented in the Condensed Balance Sheet, the Condensed Statement of Income and Retained Earnings and the Condensed Statement of Comprehensive Income as follows (in millions):

Condensed Balance Sheet

Derivatives not Designated as Hedging Instruments	Balance Sheet Location	March 31, 2015 ⁽¹⁾		December 31, 2014 ⁽¹⁾	
		Assets	Liabilities	Assets	Liabilities
Currency Swaps	Currency and interest rate swaps				
	Investments - Trading	\$ 171	\$ 102	\$ 111	\$ 4
	Loans	397	6	306	136
	Borrowings	1,069	2,205	1,319	1,534
	Accrued interest and other charges	33	(113)	56	(97)
Interest Rate Swaps	Currency and interest rate swaps				
	Investments - Trading	10	55	25	37
	Loans	1	839	2	740
	Borrowings	1,272	113	1,047	209
	Other	55	3	51	9
	Accrued interest and other charges	137	57	199	20
		<u>\$ 3,145</u>	<u>\$ 3,267</u>	<u>\$ 3,116</u>	<u>\$ 2,592</u>

⁽¹⁾ Balances are reported gross, prior to counterparty netting in accordance with existing master netting derivative agreements.

Condensed Statement of Income and Retained Earnings and Condensed Statement of Comprehensive Income

Derivatives not Designated as Hedging Instruments	Location of Gain or (Loss) from Derivatives	Three months ended March 31,	
		2015	2014
Currency Swaps			
Investments - Trading	Income from Investments:		
	Interest	\$ (11)	\$ (3)
	Net gains	13	3
	Net fair value adjustments on non-trading portfolios and foreign currency transactions	147	5
	Loans	Income from loans, after swaps	(24)
	Net fair value adjustments on non-trading portfolios and foreign currency transactions	124	25
Borrowings	Borrowing expenses, after swaps	192	209
	Net fair value adjustments on non-trading portfolios and foreign currency transactions	(1,024)	376
Interest Rate Swaps			
Investments - Trading	Income from Investments:		
	Interest	(21)	(14)
	Net gains	(36)	8
Loans	Income from loans, after swaps	(68)	(73)
	Net fair value adjustments on non-trading portfolios and foreign currency transactions	(100)	(87)
	Borrowings	Borrowing expenses, after swaps	205
	Net fair value adjustments on non-trading portfolios and foreign currency transactions	326	105
Other	Other interest income	9	11
	Net fair value adjustments on non-trading portfolios and foreign currency transactions	9	-
		<u>\$ (259)</u>	<u>\$ 739</u>

Currently, the Bank is not required to post collateral under its derivative agreements. Should the Bank's credit rating be downgraded from the current AAA, the standard swap agreements detail, by swap counterparty, the collateral requirements that the Bank would need to satisfy in this event. The aggregate fair value of all derivative instruments with credit-risk related contingent features that are in a liability position at March 31, 2015 is \$1,183 million (\$612 million at December 31, 2014) (after consideration of master netting derivative agreements). If the Bank was downgraded one notch from the current AAA credit rating, it would be required to post collateral in the amount of \$447 million at March 31, 2015 (\$155 million at December 31, 2014).

The following tables provide information on the contract value/notional amounts of derivative instruments as of March 31, 2015 and December 31, 2014 (in millions). Currency swaps are shown at face value and interest rate swaps are shown at the notional amount of each individual payable or receivable leg. Included in the Other category are interest rate swaps used to maintain the equity duration within policy limits.

March 31, 2015				
Derivative type/ Rate type	Currency swaps		Interest Rate swaps	
	Receivable	Payable	Receivable	Payable
Investments				
Fixed	\$ -	\$ 4,469	\$ -	\$ 8,490
Adjustable	4,691	-	8,490	-
Loans				
Fixed	-	708	48	8,493
Adjustable	3,246	2,135	8,493	48
Borrowings				
Fixed	17,761	107	46,634	349
Adjustable	1,459	21,153	4,719	50,149
Other				
Fixed	-	-	2,345	388
Adjustable	-	-	388	2,345
December 31, 2014				
Derivative type/ Rate type	Currency swaps		Interest Rate swaps	
	Receivable	Payable	Receivable	Payable
Investments				
Fixed	\$ -	\$ 2,094	\$ -	\$ 7,987
Adjustable	2,240	-	7,987	-
Loans				
Fixed	-	1,347	57	8,837
Adjustable	3,142	1,592	8,837	57
Borrowings				
Fixed	17,929	107	46,074	348
Adjustable	1,502	20,291	3,969	48,335
Other				
Fixed	-	-	2,453	400
Adjustable	-	-	400	2,453

The Bank's derivatives are subject to enforceable master netting agreements (the Agreements). The Bank has made the accounting policy election to present all derivative assets and liabilities on a gross basis. The gross and net information about the Bank's derivatives subject to the Agreements as of March 31, 2015 and December 31, 2014 are as follows (in millions):

March 31, 2015				
Description	Gross Amounts of Assets Presented in the Balance Sheet ⁽¹⁾	Gross Amounts Not Offset in the Balance Sheet		Net Amount
		Financial Instruments	Collateral Received ⁽³⁾	
Derivatives	\$ 3,145	\$ (2,084)	\$ (1,006)	\$ 55
December 31, 2014				
Description	Gross Amounts of Assets Presented in the Balance Sheet ⁽¹⁾	Gross Amounts Not Offset in the Balance Sheet		Net Amount
		Financial Instruments	Collateral Received ⁽³⁾	
Derivatives	\$ 3,116	\$ (1,980)	\$ (1,015)	\$ 121
Description	Gross Amounts of Liabilities Presented in the Balance Sheet ⁽²⁾	Gross Amounts Not Offset in the Balance Sheet		Net Amount
		Financial Instruments	Collateral Pledged	
Derivatives	\$ (3,267)	\$ 2,084	\$ -	\$ (1,183)
Description	Gross Amounts of Liabilities Presented in the Balance Sheet ⁽²⁾	Gross Amounts Not Offset in the Balance Sheet		Net Amount
		Financial Instruments	Collateral Pledged	
Derivatives	\$ (2,592)	\$ 1,980	\$ -	\$ (612)

⁽¹⁾ Includes accrued interest of \$170 million and \$255 million, in 2015 and 2014, respectively, presented in the Condensed Balance Sheet under Accrued interest and other charges.

⁽²⁾ Includes accrued interest of \$(56) million and \$(77) million, in 2015 and 2014, respectively, presented in the Condensed Balance Sheet under Accrued interest and other charges.

⁽³⁾ Includes cash collateral amounting to \$571 million (2014 - \$398 million). The remaining amounts represent off-Balance Sheet U.S. Treasury securities received as collateral by the Bank.

The Bank enters into swaps and other over-the-counter derivatives directly with trading counterparties. These derivatives are entered into under trade relationship documents based upon standard forms published by the International Swaps and Derivatives Association (ISDA), in particular an ISDA Master Agreement (the ISDA Agreement).

Close-out netting provisions

The close-out netting provisions of the ISDA Agreements provide for the calculation of a single lump sum amount upon the early termination of transactions following the occurrence of an event of default or termination event. The setoff provisions of the ISDA Agreements allow the non-defaulting party to determine whether setoff applies and, if so, provide that any lump sum amount calculated following the early termination of transactions payable by the non-defaulting party to the other party may be applied to reduce any amounts that the other party owes the non-defaulting party under other agreements between them. This setoff, if enforceable in the circumstances of a given early termination, effectively reduces the amount payable by the non-defaulting party under the applicable ISDA Agreement.

Terms of collateral agreements

Currently, the Bank is not required to post collateral under its ISDA Agreements. The performance of the obligations of the Bank's counterparties may be supported by collateral provided under a credit support annex (CSA). The CSA provides for credit support to collateralize the Bank's mark-to-market exposure to its counterparties in the form of U.S. Dollars and U.S. Treasury Obligations. The Bank may sell, pledge, re-hypothecate or otherwise treat as its own property such collateral, where permissible, subject only to the obligation (i) to return such collateral and (ii) to pass on distributions with respect to any non-cash collateral.

If an event of default has occurred, the Bank may exercise certain rights and remedies with respect to the collateral. These rights include (i) all rights and remedies available to a secured party; (ii) the right to set off any amounts payable by the counterparty with respect to any obligations against any collateral held by the Bank; and (iii) the right to liquidate any collateral held by the Bank.

The Bank classifies the cash collateral received under Cash flows from financing activities in the Statement of Cash Flows as this collateral primarily relates to borrowing swaps.

NOTE H – FAIR VALUE MEASUREMENTS

The framework for measuring fair value establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are as follows:

- Level 1 -Unadjusted quoted prices for identical assets or liabilities in active markets;
- Level 2 -Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or pricing models for which all significant inputs are observable, either directly or indirectly, for substantially the full term of the asset or liability;
- Level 3 -Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

The Bank's investment instruments valued based on quoted market prices in active markets, a valuation technique consistent with the market approach, may include obligations of the United States and certain other sover-

eign governments. Such instruments are classified within Level 1 of the fair value hierarchy.

Substantially all other Bank investment instruments are valued based on quoted prices in markets that are not active, external pricing services, where available, solicited broker/dealer prices or prices derived from alternative pricing models, utilizing available observable market inputs and discounted cash flows. These methodologies apply to investments in obligations of governments and agencies, corporate bonds, asset-backed and mortgage-backed securities, bank obligations, and related financial derivative instruments. These instruments are classified within Level 2 of the fair value hierarchy and are measured at fair value using valuation techniques consistent with the market and income approaches.

The main methodology of external pricing service providers involves a "market approach" that requires a predetermined activity volume of market prices to develop a composite price. The market prices utilized are provided by orderly transactions being executed in the relevant market; transactions that are not orderly and outlying market prices are filtered out in the determination of the composite price. Other external price providers utilize evaluated pricing models that vary by asset class and incorporate available market information through benchmark curves, benchmarking of like securities, sector groupings, and matrix pricing to prepare valuations.

Investment securities are also valued with prices obtained from brokers/dealers. Brokers/dealers' prices may be based on a variety of inputs ranging from observed prices to proprietary valuation models. The Bank reviews the reasonability of brokers/dealers' prices via the determination of fair value estimates from internal valuation techniques that use observable market inputs.

Medium-and long-term borrowings elected under the fair value option and all currency and interest rate swaps are valued using quantitative models, including discounted cash flow models as well as more advanced option modeling techniques, when necessary depending on the specific structures of the instruments. These models and techniques require the use of multiple market inputs including market yield curves, and/or exchange rates, interest rates, spreads, volatilities and correlations. Significant market inputs are observable during the full term of these instruments. The Bank also considers, consistent with the requirements of the framework for measuring fair value, the impact of its own creditworthiness in the valuation of its liabilities. These instruments are classified within Level 2 of the fair value hierarchy in view of the observability of the significant inputs to the models and are measured at fair

value using valuation techniques consistent with the market and income approaches.

Level 3 investment, borrowing and swap instruments, if any, are valued using Management's best estimates utilizing available information including (i) external price providers, where available, or broker/dealer prices; when less liquidity exists, a quoted price is out of date or prices among brokers/dealers vary significantly, other valuation techniques may be used (i.e., a combination of the market approach and the income approach) and (ii) market yield curves of other instruments, used as a proxy for the in-

struments' yield curves, for borrowings and related swaps. These methodologies are valuation techniques consistent with the market and income approaches.

The following tables set forth the Bank's financial assets and liabilities that were accounted for at fair value as of March 31, 2015 and December 31, 2014 by level within the fair value hierarchy (in millions). As required by the framework for measuring fair value, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Financial assets:

Assets	Fair Value Measurements			
	March 31, 2015 ⁽¹⁾	Level 1	Level 2	Level 3
Investments - Trading:				
Obligations of the United States Government and its corporations and agencies	\$ 4,958	\$ 4,958	\$ -	\$ -
U.S. Government-sponsored enterprises	204	-	204	-
Obligations of non-U.S. governments	6,169	1,948	4,221	-
Obligations of non-U.S. agencies	8,935	-	8,935	-
Obligations of non-U.S. sub-sovereigns	2,066	-	2,066	-
Obligations of supranationals	1,401	-	1,401	-
Bank obligations ⁽²⁾	4,888	-	4,888	-
Corporate securities	186	-	186	-
Mortgage-backed securities	300	-	300	-
Asset-backed securities	93	-	78	15
Total Investments - Trading	29,200	6,906	22,279	15
Currency and interest rate swaps	3,145	-	3,145	-
Total	<u>\$ 32,345</u>	<u>\$ 6,906</u>	<u>\$ 25,424</u>	<u>\$ 15</u>

⁽¹⁾ Represents the fair value of the referred assets, including their accrued interest presented on the Condensed Balance Sheet under Accrued interest and other charges of \$75 million for trading investments and \$170 million for currency and interest rate swaps.

⁽²⁾ May include bank notes and bonds, certificates of deposit, commercial paper, and money market deposits.

Assets	Fair Value Measurements			
	December 31, 2014 ⁽¹⁾	Level 1	Level 2	Level 3
Investments - Trading:				
Obligations of the United States Government and its corporations and agencies	\$ 5,435	\$ 4,935	\$ 500	\$ -
U.S. Government-sponsored enterprises	599	-	599	-
Obligations of non-U.S. governments	3,959	1,043	2,916	-
Obligations of non-U.S. agencies	9,427	-	9,427	-
Obligations of non-U.S. sub-sovereigns	1,667	-	1,667	-
Obligations of supranationals	1,430	-	1,430	-
Bank obligations ⁽²⁾	4,054	-	4,054	-
Corporate securities	423	-	423	-
Mortgage-backed securities	345	-	345	-
Asset-backed securities	110	-	95	15
Total Investments - Trading	27,449	5,978	21,456	15
Currency and interest rate swaps	3,116	-	3,116	-
Total	<u>\$ 30,565</u>	<u>\$ 5,978</u>	<u>\$ 24,572</u>	<u>\$ 15</u>

⁽¹⁾ Represents the fair value of the referred assets, including their accrued interest presented on the Balance Sheet under Accrued interest and other charges of \$54 million for trading investments and \$255 million for currency and interest rate swaps.

⁽²⁾ May include bank notes and bonds, certificates of deposit, commercial paper, and money market deposits.

Financial liabilities:

Liabilities	Fair Value Measurements			
	March 31, 2015⁽¹⁾	Level 1	Level 2	Level 3
Borrowings measured at fair value	\$ 48,477	\$ -	\$ 48,477	\$ -
Currency and interest rate swaps	3,267	-	3,267	-
Total	<u>\$ 51,744</u>	<u>\$ -</u>	<u>\$ 51,744</u>	<u>\$ -</u>

⁽¹⁾ Represents the fair value of the referred liabilities, including their accrued interest presented on the Condensed Balance Sheet under Accrued interest on borrowings of \$296 million for borrowings and under Accrued interest and other charges of \$(56) million for currency and interest rate swaps.

Liabilities	Fair Value Measurements			
	December 31, 2014⁽¹⁾	Level 1	Level 2	Level 3
Borrowings measured at fair value	\$ 49,245	\$ -	\$ 49,245	\$ -
Currency and interest rate swaps	2,592	-	2,592	-
Total	<u>\$ 51,837</u>	<u>\$ -</u>	<u>\$ 51,837</u>	<u>\$ -</u>

⁽¹⁾ Represents the fair value of the referred liabilities, including their accrued interest presented on the Balance Sheet under Accrued interest on borrowings of \$364 million for borrowings and under Accrued interest and other charges of \$(77) million for currency and interest rate swaps.

As of March 31, 2015, the investment portfolio includes \$15 million (\$15 million at December 31, 2014) of securities classified as Level 3. The pricing information for these securities is not developed or adjusted by the Bank, and is obtained through external pricing sources.

The significant unobservable inputs used in the fair value measurements of the Bank's investments in asset-backed securities classified as Level 3 are prepayment rates, probability of default, and loss severity in the event of default. Significant increases (decreases) in any of those inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally opposite change in the assumption used for prepayment rates.

The Treasury Division is responsible for mark-to-market valuations for financial statement purposes of investments, borrowings, and derivatives, including those with significant unobservable inputs, and reports to the Treasurer of the Bank. The Accounting Division is responsible for monitoring, controlling, recording and reporting fair values related to investments, borrowings and all derivatives. The two groups work in close coordination to monitor the reasonableness of fair values. Such monitoring includes but is not limited to validation against counterparty values, internally developed models, and independent price quotes for similar instruments, when available. The tables below show a reconciliation of the beginning and ending balances of all financial assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2015 and 2014 (in millions). There were no Level 3 financial liabilities for the three months ended March 31, 2015 and 2014.

Financial assets:

	Three months ended March 31,					
	2015			2014		
	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)			Fair Value Measurements Using Significant Unobservable Inputs (Level 3)		
	Investments - Trading	Currency and Interest Rate Swaps	Total	Investments - Trading	Currency and Interest Rate Swaps	Total
Balance, beginning of period	\$ 15	\$ -	\$ 15	\$ 20	\$ -	\$ 20
Total gains included in Net income ⁽¹⁾	1	-	1	1	-	1
Settlements	(1)	-	(1)	(4)	-	(4)
Balance, end of period	<u>\$ 15</u>	<u>\$ -</u>	<u>\$ 15</u>	<u>\$ 17</u>	<u>\$ -</u>	<u>\$ 17</u>
Total gains for the period included in Net income attributable to the change in unrealized gains or losses related to assets still held at the end of the period ⁽¹⁾	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 1</u>	<u>\$ 1</u>	<u>\$ -</u>	<u>\$ 1</u>

⁽¹⁾ Gains on Level 3 financial assets are reported in Income from Investments - Net gains in the Condensed Statement of Income and Retained Earnings.

There were no transfers between levels during the first three months of 2015 and the year 2014, for securities held at the end of those reporting periods. The Bank's policy for transfers between levels is to reflect these transfers as of the beginning of the reporting period.

The Bank accounts for its loans and certain borrowings at amortized cost with their corresponding fair value disclosures included in Note P – Fair Values of Financial Instruments.

The fair value of the loan portfolio, which amounted to approximately \$78,512 million as of March 31, 2015 (\$77,053 million as of December 31, 2014) was determined using a discounted cash flow method (income approach) by which cash flows are discounted at (i) applicable market yield curves adjusted for the Bank's own funding cost plus its lending spread, for sovereign-guaranteed loans, and (ii) market yield curves consistent with the borrower's S&P credit rating equivalent, for non-sovereign-guaranteed loans. The Bank is one of the very few lenders of development loans to Latin American and Caribbean countries and, it does not sell its loans nor does it believe there is a comparable market for its loans. Therefore, this methodology has been developed based on valuation assumptions that management believes a market participant in an assumed transaction would use in pricing the Bank's loans. The Bank considers that, for its sovereign-guaranteed loans, multilateral lending institutions that share the Bank's developmental mission would constitute the most appropriate assumed market participants to which the Bank would sell its loans in an orderly transaction. The valuation assumptions used include observable inputs, such, as the market yield curves mainly based on LIBOR, and unobservable inputs, such as internal credit risk assumptions. Due to the fact that the unobservable inputs are considered sig-

nificant, the fair value disclosure of the Bank's loan portfolio has been classified as Level 3.

The fair value of borrowings recorded at amortized cost, which amounted to approximately \$31,803 million as of March 31, 2015 (\$28,963 million as of December 31, 2014) was determined using the same inputs and valuation techniques as disclosed above for the borrowings recorded at fair value.

Such valuation techniques are based on discounted cash flows or pricing models (income approach) and utilize market observable inputs. Accordingly, the fair value disclosure for borrowings recorded at amortized cost is considered Level 2 under the fair value hierarchy.

NOTE I – NET FAIR VALUE ADJUSTMENTS ON NON-TRADING PORTFOLIOS AND FOREIGN CURRENCY TRANSACTIONS

Net fair value adjustments on non-trading portfolios and foreign currency transactions gains and losses for the three months ended March 31, 2015 and 2014 comprise the following (in millions):

	Three months ended	
	March 31,	
	2015	2014
Fair value adjustments - gains (losses) ⁽¹⁾		
Borrowings	\$ 902	\$ (364)
Derivatives		
Borrowing swaps	(698)	481
Lending swaps	24	(62)
Equity duration swaps	9	-
Currency transaction losses on borrowings and loans at amortized cost, and other	(156)	(30)
	<u>\$ 81</u>	<u>\$ 25</u>

⁽¹⁾ Amounts include foreign currency transaction gains and losses, as detailed below

Net fair value adjustments of \$81 million (2014 - \$25 million) mostly relate to changes in the fair value of (a) borrowings at fair value due to changes in the Bank's own credit spreads, (b) lending and certain borrowing swaps due to changes in USD interest rates, which are not offset with changes in the value of the related loans and borrowings that are not recorded at fair value, as well as (c) equity duration swaps due to changes in USD interest rates.

The Bank transacts in multiple currencies. However, assets and liabilities, after swaps, are substantially held in United States dollars. The Bank minimizes exchange rate risk by matching the currencies of its liabilities with those of its assets and by maintaining basically all its equity in United States dollars. Accordingly, exchange rate fluctuations have a minimum impact on earnings. The impact of foreign exchange fluctuations, included in the table above, for the three months ended March 31, 2015 and 2014, comprise the following (in millions):

	Three months ended March 31,	
	2015	2014
Currency transaction gains (losses):		
Borrowings, at fair value	\$ 1,213	\$ (302)
Derivatives, at fair value:		
Borrowing swaps	(1,163)	333
Lending swaps	108	1
	<u>158</u>	<u>32</u>
Currency transaction gains (losses) related to:		
Borrowings at amortized cost	22	(31)
Loans	(107)	(2)
Other	(71)	3
	<u>(156)</u>	<u>(30)</u>
Total	<u>\$ 2</u>	<u>\$ 2</u>

NOTE J – BOARD OF GOVERNORS APPROVED TRANSFERS

As part of the ninth general increase in the resources of the Bank (IDB-9), the Board of Governors agreed, in principle and subject to annual approvals by the Board of Governors and in accordance with the Agreement Establishing the Inter-American Development Bank (the Agreement), to provide \$200 million annually in transfers of Ordinary Capital income to the IDB Grant Facility, beginning in 2011 and through 2020. At its annual meeting in Busan, Republic of Korea, in March 2015, the Board of Governors approved the \$200 million transfer corresponding to 2015. Such transfers are recognized as an expense when approved by the Board of Governors and funded in accordance with the IDB Grant Facility funding requirements. The undisbursed portion of approved transfers is presented under Due to IDB Grant Facility on the Condensed Balance Sheet.

NOTE K – CAPITAL STOCK

On February 29, 2012, the IDB-9 entered into effect providing for an increase in the Bank's Ordinary Capital of \$70,000 million, which is being subscribed to by Bank members in five annual installments beginning in 2012. Of this amount, \$1,700 million is paid-in capital stock and the remainder constitutes callable capital stock.

On February 28, 2015, the effective date of the fourth installment, 1,121,078 shares in the amount of \$13,525 million were made effective (\$342 million paid-in; \$13,183 million callable), after Canada's exchange of temporary callable shares.

In 2009, Canada subscribed to 334,887 shares of non-voting callable capital stock. The terms and conditions of Canada's subscription stipulated that the subscription was on a temporary basis, with Canada having the right to replace its temporary subscription with shares issued under a future capital increase, as and when effective. Accordingly, when the IDB-9 became effective, Canada exercised its right, and as of March 31, 2015, has replaced a total of 181,212 non-voting callable shares in the amount of \$2,186 million with an equal amount of voting callable shares. In addition, in July 2014 Canada returned 83,722 callable shares in the amount of \$1,010 million. The remaining amount of non-voting callable shares will be returned in July 2015.

The changes in subscribed capital during the three months ended March 31, 2015 and the year ended December 31, 2014 were as follows (in millions, except for share information):

	Subscribed capital			
	Shares	Paid-in	Callable	Total
Balance at January 1, 2014	10,675,321	\$ 4,941	\$ 123,840	\$ 128,781
Subscriptions during 2014	1,421,933	416	16,737	17,153
Canada's replacement of callable capital	(55,193)	-	(666)	(666)
Canada's return of callable capital	(83,722)	-	(1,010)	(1,010)
Balance at December 31, 2014	11,958,339	5,357	138,901	144,258
Subscriptions during 2015	1,166,381	342	13,729	14,071
Canada's replacement of callable capital	(45,303)	-	(546)	(546)
Balance at March 31, 2015	<u>13,079,417</u>	<u>\$ 5,699</u>	<u>\$ 152,084</u>	<u>\$ 157,783</u>

The changes in Capital subscriptions receivable during the three months ended March 31, 2015 and the year ended December 31, 2014, were as follows (in millions):

	Capital Subscriptions Receivable
Balance at January 1, 2014	\$ 1
Subscriptions during 2014	416
Collections	(248)
Amounts paid in advance that became effective in 2014	(85)
Balance at December 31, 2014	84
Subscriptions during 2015	342
Collections	(168)
Amounts paid in advance that became effective in 2015	(70)
Balance at March 31, 2015	<u>\$ 188</u>

Capital subscriptions receivable have been recorded as a reduction from equity in the Condensed Balance Sheet.

NOTE L – PENSION AND POSTRETIREMENT BENEFIT PLANS

The Bank has two defined benefit retirement plans (Plans) for providing pension benefits to employees of the Bank: the Staff Retirement Plan for international employees, and the Local Retirement Plan for national employees in the country offices. The Bank also provides health care and certain other benefits to retirees under the Postretirement Benefits Plan (PRBP).

CONTRIBUTIONS: All contributions are made in cash during the fourth quarter of the year. As of March 31, 2015, the estimate of contributions expected to be paid to the Plans and the PRBP for the year 2015 was \$70 million and \$31 million, respectively, the same amount disclosed in the December 31, 2014 financial statements. Contributions for 2014 were \$52 million and \$28 million, respectively.

PERIODIC BENEFIT COST: Net periodic benefit costs are allocated between the Ordinary Capital and the FSO in accordance with an allocation percentage approved by the Board of Governors for administrative expenses and are included under Administrative expenses in the Condensed Statement of Income and Retained Earnings.

The following table summarizes the benefit costs associated with the Plans and the PRBP for the three months ended March 31, 2015 and 2014 (in millions):

	Pension Benefits	
	Three months ended	
	March 31,	
	2015	2014
Service cost	\$ 27	\$ 20
Interest cost	37	38
Expected return on plan assets ⁽¹⁾	(51)	(51)
Amortization of net actuarial losses	6	-
Net periodic benefit cost	<u>\$ 19</u>	<u>\$ 7</u>
Of which:		
ORC's share	\$ 18	\$ 7
FSO's share	1	-

⁽¹⁾ The expected return of plan assets was 6.25% in 2015 (2014 - 6.75%).

	Postretirement Benefits	
	Three months ended	
	March 31,	
	2015	2014
Service cost	\$ 14	\$ 11
Interest cost	19	19
Expected return on plan assets ⁽¹⁾	(22)	(21)
Amortization of:		
Prior service credit	(1)	-
Net actuarial losses	6	-
Net periodic benefit cost	<u>\$ 16</u>	<u>\$ 9</u>
Of which:		
ORC's share	\$ 16	\$ 9
FSO's share	-	-

⁽¹⁾ The expected return of plan assets was 6.25% in 2015 (2014 - 6.75%).

NOTE M – VARIABLE INTEREST ENTITIES

The Bank has identified loans and guarantees to Variable Interest Entities (VIEs) in which it is not the primary beneficiary but in which it is deemed to hold significant variable interest at March 31, 2015. The majority of these VIEs do not involve securitizations or other types of structured financing. These VIEs are mainly: (i) special purpose vehicles or investment funds, where the sponsor, the general partner or fund manager does not have substantive equity at risk; (ii) operating entities where the total equity investment is considered insufficient to permit such entity to finance its activities without additional subordinated financial support; and (iii) entities where the operating activities are so narrowly defined by contracts (e.g. concession contracts) that equity investors are considered to lack decision making ability.

The Bank's involvement with these VIEs is limited to loans and guarantees, which are reflected as such in the Bank's financial statements. Based on the most recent available data from these VIEs, the size of the VIEs

measured by total assets in which the Bank is deemed to hold significant variable interests totaled \$7,121 million at March 31, 2015 and \$7,223 million at December 31, 2014. The Bank's total loans and guarantees outstanding to these VIEs were \$467 million and \$70 million, respectively (\$479 million and \$76 million, respectively, at December 31, 2014). Amounts committed not yet disbursed related to such loans and guarantees amounted to \$38 million (\$38 million at December 31, 2014), which combined with outstanding amounts results in a total maximum Bank exposure of \$575 million at March 31, 2015 (\$593 million at December 31, 2014).

Of those loans and guarantees where the Banks is deemed to hold a significant variable interest, the Bank has made a loan amounting to approximately \$32 million to one VIE for which the Bank is deemed to be the primary beneficiary. The Bank's involvement with this VIE is limited to such loan, which is reflected as such in the Bank's financial statements. Based on the most recent available data, the size of this VIE measured by total assets amounted to approximately \$32 million, which is considered immaterial and, thus, not consolidated with the Bank's financial statements.

NOTE N – RECONCILIATION OF NET INCOME TO NET CASH USED IN OPERATING ACTIVITIES

A reconciliation of Net income to Net cash used in operating activities, as shown on the Condensed Statement of Cash Flows, is as follows (in millions):

	Three months ended March 31,	
	2015	2014
Net income	\$ 68	\$ 61
Difference between amounts accrued and amounts paid or collected for:		
Loan income	(196)	(86)
Income from investments	(9)	20
Other interest income	1	-
Interest and other costs of borrowings, after swaps	(188)	47
Administrative expenses, including depreciation	11	(11)
Special programs	(10)	(6)
Net fair value adjustments on non-trading portfolios and foreign currency transactions	(81)	(25)
Transfers to the IDB Grant Facility	186	178
Net increase in trading investments	(1,754)	(3,937)
Net unrealized gains on trading investments	(6)	(16)
Provision for loan and guarantee losses	19	4
Net cash used in operating activities	<u>\$ (1,959)</u>	<u>\$ (3,771)</u>
Supplemental disclosure of noncash activities		
Increase (decrease) resulting from exchange rate fluctuations:		
Trading investments	\$ (55)	\$ 4
Loans outstanding	2	(1)
Borrowings	(73)	-

NOTE O – SEGMENT REPORTING

Management has determined that the Bank has only one reportable segment since the Bank does not manage its operations by allocating resources based on a determination of the contributions to net income of individual operations. The Bank does not differentiate between the nature of the products or services provided, the preparation process, or the method for providing the services among individual countries.

For the three months ended March 31, 2015 and 2014, loans made to or guaranteed by three countries individually generated in excess of 10% of loan income, before swaps, as follows (in millions):

	Three months ended March 31,	
	2015	2014
Argentina	\$ 88	\$ 94
Brazil	63	63
Mexico	111	110

NOTE P – FAIR VALUES OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Bank in measuring the fair value for its financial instruments:

Cash: The carrying amount reported in the Condensed Balance Sheet for cash approximates fair value.

Investments: Fair values for investment securities are based on quoted prices, where available; otherwise they are based on external pricing services, independent dealer prices, or discounted cash flow models.

Loans: The fair value of the Bank's loan portfolio is estimated using a discounted cash flow method as discussed in Note H – Fair Value Measurements.

Swaps: Fair values for interest rate and currency swaps are based on discounted cash flows or pricing models.

Borrowings: The fair values of borrowings are based on discounted cash flows or pricing models.

The following table presents the fair values of the financial instruments, along with the respective carrying amounts, as of March 31, 2015 and December 31, 2014 (in millions):

	March 31, 2015 ⁽¹⁾		December 31, 2014 ⁽¹⁾	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash	\$ 742	\$ 742	\$ 535	\$ 535
Investments - Trading	29,200	29,200	27,449	27,449
Loans outstanding, net	75,710	78,512	74,640	77,053
Currency and interest rate swaps receivable				
Investments - Trading	160	160	123	123
Loans	384	384	293	293
Borrowings	2,544	2,544	2,647	2,647
Others	57	57	53	53
Borrowings				
Short-term	701	701	675	675
Medium- and long-term:				
Measured at fair value	48,477	48,477	49,245	49,245
Measured at amortized cost	30,456	31,803	27,881	28,963
Currency and interest rate swaps payable				
Investments - Trading	195	195	62	62
Loans	896	896	934	934
Borrowings	2,173	2,173	1,587	1,587
Others	3	3	9	9

⁽¹⁾ Includes accrued interest.

NOTE Q – SUBSEQUENT EVENTS

Management has evaluated subsequent events through May 14, 2015, which is the date the financial statements were issued. As a result of this evaluation, there are no subsequent events that require recognition or disclosure in the Bank's Condensed Quarterly Financial Statements as of March 31, 2015.