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# HOW CAN THE U.S. MAKE DEVELOPMENT BANKS MORE ACCOUNTABLE?

## HEARING

BEFORE THE

SUBCOMMITTEE ON MONETARY POLICY AND TRADE

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

SECOND SESSION

APRIL 27, 2016

Printed for the use of the Committee on Financial Services

**Serial No. 114–85**

U.S. GOVERNMENT PUBLISHING OFFICE

24–065 PDF WASHINGTON : 2017

For sale by the Superintendent of Documents, U.S. Government Publishing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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# HOW CAN THE U.S. MAKE DEVELOPMENT BANKS MORE ACCOUNTABLE?

**Wednesday, April 27, 2016**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON MONETARY
POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Bill Huizenga [chairman of the subcommittee] presiding.

Members present: Representatives Huizenga, Mulvaney, Pearce, Pittenger, Schweikert, Guinta, Love; Moore, Foster, Himes, Kildee, and Heck.

Ex officio present: Representative Hensarling.

Also present: Representatives Meeks and Hinojosa.

Chairman HUIZENGA. The Subcommittee on Monetary Policy and Trade will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "How Can the U.S. Make Development Banks More Accountable?" I now recognize myself for 5 minutes to give an opening statement.

The origins of multilateral development banks, or MDBs, lie within the creation of the World Bank at Bretton Woods in 1944. Today, the MDBs include not only the World Bank and its other lending arms—the IBRD and the International Development Association (IDA)—but also four regional banks: the African Development Bank; the European Bank for Reconstruction and Development; the Inter-American Development Bank; and the Asian Development Bank. Their core mission is to provide financial assistance such as loans and grants to developing countries to promote economic and social development.

The multilateral development banks, or MDBs, can provide the capital to sustain MDB operations. Member countries are awarded shares in MDBs in proportion to the amount of capital that they provide. Because member nations provide the MDBs with a large capital base, the MDBs have a AAA credit rating, which allows them to borrow at favorable rates from private lenders. Because the United States is a member of each of these institutions, Congress plays a very important role in determining U.S. funding for those MDBs and engaging in the oversight of the Administration's participation in the MDBs.

Although the Treasury Department represents the United States at the MDBs, and negotiates the amounts committed to them for

general capital increases and the replenishment of concessional loan windows, only Congress has the constitutional authority to authorize and appropriate the funds required to fulfill these commitments.

The U.S. Constitution details the power as well as the limitations of each Branch of Government. As the Legislative Branch of Government, Congress is the one to make laws of the United States of America. Additionally, it is Congress and Congress alone, not the President or any other Branch, that controls appropriations funding.

On previous occasions, the Treasury has pledged money to an MDB without consulting Congress to the degree I believe it should, and then criticized this very body for not appropriating the full amount and failing to meet those commitments. In fact, Treasury has falsely claimed that Congress damaged U.S. credibility by failing to deliver on policy commitments made by Treasury that they didn't have the authority to make.

It is important to note that some have said that the cost of funding the U.S. commitment to MDBs outweighs the benefits derived from them. This is because those MDBs have not necessarily supported U.S. interests, failed to meet their development goals, and failed to sufficiently combat corruption and abuses of individual rights in the nations which receive that MDB support. This is one of particular interest for me. Others have called for MDBs to focus more on public goods in order to minimize the risk of crowding out private lenders in that same space.

Currently, the Obama Administration is undertaking negotiations for a 3-year replenishment of the World Bank's and African Development Bank's concessional loan windows, and is also in discussions of to how to alter the other institutions, including the Inter-American Development Bank, to finance future initiatives.

Lastly, the Administration has proposed a doubling of the North American Development Bank, also known as NAD Bank, doubling their capital, the first such increase since its inception around the time of NAFTA.

Today's hearing will examine the Administration's plans regarding these matters, many of which are contingent on congressional authorization, while addressing whether development banks are improving outcomes for low-income beneficiaries in a cost-effective manner.

And with that, I will yield back the yield back the balance of my time.

The Chair now recognizes the ranking member of the subcommittee, the gentlelady from Wisconsin, Ms. Moore, for 5 minutes for an opening statement.

Ms. MOORE. Thank you so much, Mr. Chairman.

Mr. Sheets, I want to welcome you again to the committee. I have read your testimony and I think you make some really powerful points on the utility and power of these development banks.

I am a card-carrying liberal with an incredibly deep and personal connection to the least, the last, and the lost in this country and around the world. So I don't think that I am going to shock anyone when I say that I believe the United States has a moral obligation to help poor people anywhere they are.

But I am also a realist. The United States can't do this alone. We must leverage our commitment with other countries in the world and with private capital. And I think America is helping Americans when we support the work of development banks. It is just amazing to think about the close nexus of providing assistance and aid to people who are marginalized and maintaining our national security interests.

We have talked about the importance of opening global markets around here a lot. We don't do that by waiving some sort of wand. We do that by supporting these development banks. These development banks can play an expanding role in helping business operate in some of these markets.

Now, I don't want to rehash all of your points that you make in your written testimony, but I do want to make one point related to our development bank policy. As great a tool as this can be, we have to do it the right way.

So I want to emphasize the need for a strong, enforceable safeguard regimen. I also want to flag for you a letter I wrote to the IFC about its conflict policy. I get it that we want to be creative and leverage private capital in these projects and I am all for it, but this letter is about how to do it the right way. And I consider this to be an ongoing dialogue, so I am not going to belabor the point, but I do want to make sure that we are looking at these programs and these moneys and we do it the right way.

Thank you so much, and I yield back.

Chairman HUIZENGA. The gentlelady yields back.

With that, today we welcome the testimony of Dr. Nathan Sheets, who is the Under Secretary for International Affairs at the U.S. Treasury. Dr. Sheets was confirmed by the U.S. Senate on September 8, 2014, to serve as the U.S. Department of the Treasury's Under Secretary for International Affairs.

Prior to joining Treasury, he was the global head of international economics at Citigroup, a position he held since September of 2011. And prior to joining Citigroup, Dr. Sheets worked at the Board of Governors of the Federal Reserve System for 18 years where he worked closely with his international counterparts, including as Director of the Board's Division of International Finance, and Economist to the Federal Open Market Committee (FOMC). So he has a deep background in this.

And I am looking forward to hearing from you. You will be recognized for 5 minutes to give your oral presentation, Dr. Sheets. Without objection, your written statement will be made a part of the record. So, Mr. Under Secretary, you are now recognized for 5 minutes.

## STATEMENT OF THE HONORABLE NATHAN SHEETS, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF THE TREASURY

Mr. SHEETS. Chairman Huizenga, Ranking Member Moore, and members of the subcommittee, thank you for the invitation to testify today. I appreciate the opportunity to discuss Treasury's role working with the multilateral development banks, or MDBs. Through our leadership in the World Bank, the regional development banks, and the International Monetary Fund, the United

States effectively influences global economic events, promotes American values, supports our allies, and helps drive inclusive growth and poverty reduction at home and around the world. The MDBs, in particular, play a vital role in the international system and in advancing American interests.

First, the MDBs support development through investments that are not possible with private capital and domestic resources alone. They provide grants and highly concessional loans to low-income countries and loans to middle-income countries. Without such support, even countries with access to capital markets may not be able to attract sufficient capital in terms consistent with the sustainability of their debt. MDBs also catalyze private sector investment and provide technical assistance, research, and data.

Second, the MDBs are important contributors to U.S. national security by playing a leading role in assisting key strategic partners such as Afghanistan, Iraq, Ukraine, and Mali.

Third, the MDBs support countries undertaking valuable reforms including strengthening governance, building accountable institutions, mobilizing domestic resources, and fighting money laundering and the financing of terrorism.

Fourth, by supporting long-term development, the MDBs help foster economic growth and fiscal sustainability, which reduces the likelihood of macroeconomic crises and countries' potential need for IMF financing.

Regional development banks complement the World Bank's reach through expertise in areas of importance to their respective regions, which developing countries strongly value. For instance, the African Development Bank focuses on infrastructure, regional integration, and food security. The Inter-American Development Bank has expertise in social protection and the development of small and medium-sized enterprises. Notably, the North American Development Bank plays a unique role through its mandate to finance environmental infrastructure on both sides of the U.S.-Mexican border.

Treasury is working to ensure that the MDBs continue to deliver on these important roles while improving their financial and operational efficiency and further strengthening their accountability and governance. As the largest shareholder in all but the African Development Bank, the United States is well-positioned to encourage the MDBs to implement such reforms.

Treasury is pushing the MDBs to improve their financial efficiency. The MDBs offer the United States significant financial leverage. The $1.8 billion request for the MDBs in the President's proposed budget should support more than $100 billion in MDB investments in developing countries.

And the MDBs are taking steps to make their resources go further. The Asian Development Bank's reforms here are particularly compelling. We will see an increase in lending capacity while allowing donors to significantly reduce contributions.

To complement efforts to boost financial efficiency, Treasury is advocating for the MDBs to enhance their operational efficiency, including streamlining project-approval processes and improving project preparation. The MDBs should take such steps without compromising high social, environmental, and fiduciary standards.

Treasury continues to work to improve accountability and good governance at these institutions. The MDBs must measure success by project outcomes rather than by the amount of financing provided. And the MDBs must reform their governance structures to reflect the changing economic realities of shareholders in fair and transparent ways.

As emerging markets seek greater influence in the MDBs, Treasury asks these countries to assume greater responsibilities, including increasing their role as donors and gradually moving away from MDB borrowing.

As we push for continued improvements at the MDBs, the United States must also fulfill its responsibilities as a leader of these institutions. The MDBs will continue to need strong financial support from the United States and other shareholders, in particular for the poorest countries. Treasury asks that Congress support the Administration's request for the Fiscal Year 2017 budget so that MDBs can provide financing to the poorest.

For the past 70 years, U.S. leadership has ensured that the MDBs and the IMF have remained critical partners in supporting U.S. strategic and economic priorities. It is crucial that the United States and these institutions, working together, continue to deliver on those priorities, including supporting peace, security, and sustainable economic growth.

Thank you, and I very much welcome your questions.

[The prepared statement of Under Secretary Sheets can be found on page 34 of the appendix.]

Chairman HUIZENGA. Thank you, Mr. Under Secretary.

At this point, I will recognize myself for 5 minutes for questioning.

I want to touch on a number of issues. Before I get into sort of the IMF negotiations with the Eurogroup and Greece and some other things, I want to talk a little bit about structure. I understand that the Asian Development Bank has, by a vote of its board, combined both its hard and its soft loan portfolios as they are dealing with it. Can you give us a quick update, very quickly, as to how that is working? And is that the model, one of the things that is being used in some of the other reforms for the other development banks?

Mr. SHEETS. That is right. The consolidation of these two windows at the Asian Development Bank we see indeed as being a model or a template for the other MDBs going forward. And specifically as a result of this consolidation, the capacity of the bank to lend both concessionally and nonconcessionally has been increased by about 40 percent. And at the same time, the necessary replenishments to its concessional window have been reduced by more than 40 percent.

Chairman HUIZENGA. So less paid in—

Mr. SHEETS. Exactly.

Chairman HUIZENGA. —direct dollars because—

Mr. SHEETS. We are paying in less and we are getting more out on the other side.

Chairman HUIZENGA. Yes, okay. That makes a ton of sense to me, so I want to encourage it.

And then who actually negotiates the numbers and the increases with the various MDBs and with the other member nations? Is that you specifically or is that Secretary Lew? Who is involved in that negotiation process?

Mr. SHEETS. Broadly speaking, it would be the leadership at the Treasury. We have a Deputy Assistant Secretary who would be the point person, who would be attending the meetings, but then it would be approved all the way up the line.

Chairman HUIZENGA. By you?

Mr. SHEETS. Including myself and the Secretary approving that.

Chairman HUIZENGA. And Secretary Lew.

All right. As I had said in my opening statement, there had been some concern from Congress—both House and Senate—and from the public comments from the Administration about a lack of willingness to support what they had negotiated. It seems to me a critical function to that would be getting us on board from the very beginning, which necessitates communication. And I hope that you will be committed to working with me, and working with the appropriations folks here in the House so that we won't have this conflict on that.

Mr. SHEETS. Indeed, we are very much open to that. We try to do our best. And we will continue to engage as necessary.

Chairman HUIZENGA. So in the 2½ minutes that I have left, I want to talk a little bit about progress on corruption and human rights and whether the MDBs have had that. And I think I am going to actually follow that up with a written question, because I do want you to clarify the current state of the IMF negotiations with the Eurogroup and Greece.

According to IMF rules, any country whose debt is found to be unsustainable, a so-called red zone country, cannot receive exceptional access assistance unless its debt is restructured to make it sustainable with high probability.

Yesterday, I believe it was, or maybe the day before, there was an article in The Wall Street Journal about negotiations stalled between Greece and the international creditors. I expressed this to Managing Director Legarde earlier, I guess the end of last week. I expressed this to Secretary Lew when I last saw him. I want to make sure that we are not setting ourselves up even for an appearance of another Greek bailout when the Greeks aren't willing to do what is necessary to right the ship. So if you would please comment on that.

Mr. SHEETS. The status of these negotiations between the Greeks and their European partners in the IMF is an issue that we follow very closely on at least a day-to-day basis.

I think the fundamental point that I would make is very consistent with the point that you were making, that the IMF has made clear that it will be involved in a Greek program in the sense of providing resources only if they are convinced that the reform program that is being put forward is a significant one and it is one where the Greek authorities themselves have significant ownership. That is a first condition that the IMF has made very clear, that this is the significant reform program. The Greeks have made progress over the last 5 years, but they still have work to do and it is imperative that—

Chairman HUIZENGA. So can you assure us today that Greece will not have access to that exceptional lending—

Mr. SHEETS. Yes.

Chairman HUIZENGA. —mechanism?

Mr. SHEETS. Yes. And then the second—

Chairman HUIZENGA. That was a "yes" acknowledging the question or a "yes" to the question?

Mr. SHEETS. I would say "yes" to both.

Chairman HUIZENGA. Okay.

Mr. SHEETS. Let me say, the second condition, which bears specifically on what you are saying, is that the IMF has made clear it will only provide resources to the Greeks if the program is accompanied by significant debt relief from Greece's European partners to ensure that condition of debt sustainability that you articulated is satisfied.

And let me further say that the IMF's position on requiring a strong program and only joining the program if there is significant debt relief is very much supported by the Treasury.

Chairman HUIZENGA. My time has expired. With that, I recognize the ranking member for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman.

And again, thank you, Secretary Sheets, for coming to speak with us today.

As I mentioned in my opening comments, I am very interested in some of the complexities of providing support and leveraging private capital with conflicts of interest that are raised. I did send a letter regarding, in particular, water policy. And I know that there have been some complaints at local levels, I am thinking in Manila and Nigeria, about these water policies.

I have come up with an astronomical figure. In Manila, for example, when the IFC, the development arm, took an equity position in the water company, water rates were raised up to 845 percent. That seems sort of unaffordable in any sort of monetary system, whatever your economy is, 845 percent seems unaffordable. And I am just wondering how that is helpful. In Nigeria, we have seen massive demonstrations regarding the equity investments in water.

So I guess, how do we bridge the gap between the notion somehow that water is a human right? In Nigeria, they talk about an old African proverb that says that water has no enemies. But it seems like water is getting to be quite a bit of an enemy as we see its unavailability to people.

There is a notion that at some level, based on it being a human right, there ought to be in place sort of a fixed subsidy that recognizes water as a human right and then a charge for usage beyond this point.

So question one, have you heard this? Can you comment on this? And what can we do to reduce the conflicts of interest?

Mr. SHEETS. Thank you.

The issues that you point to are very rich and diverse and I think really cut to the heart of the mission of the multilateral development banks. Let me just give you a few reactions to your question and a few thoughts in response, and I would be happy to talk to you directly or have my team talk to your team.

But I think that the issues you highlight, first of all, underscore the point of the necessity of there being safeguards. And the safeguards really boil down to, how do we implement the best practices and the lessons learned from development bank lending over the last 70 years? How do we implement that into the ongoing processes and lending approaches of the MDBs? And it is imperative that there be appropriate firewalls and that there be appropriate development impact assessments to think about the implications of various projects on the populations that will be experiencing that.

It is also important that the safeguards have adequate resources to ensure that they are implemented fully and that there is monitoring of projects afterwards.

I think that there is a very set rich set of issues regarding safeguards. I also think there is a very rich set of issues regarding what is a global public good, what is the global commons here that the MDBs are protecting. And I think protecting the health of populations and providing the infrastructure to support that through water or otherwise is very much at the heart and center of their mission. And I think, how do we deliver those public goods in a way that is on the one hand economically feasible, but on the other hand actually meets the real needs of the people who are being affected is a crucial question that we should be focused on and do more work on.

Ms. MOORE. And just as an extension of that, protections for women, LGBT clients, those people who are very poor. We have heard that water can reach some of the more opulent areas and the people who are very poor don't get it. So we have to make sure we get those safeguards in place and have more than just monitoring.

Mr. SHEETS. Protecting those diverse communities and ensuring human rights broadly is one of the aspects of the safeguards, and the social protections that have been put in place are important.

Ms. MOORE. Thank you for your indulgence, Mr. Chairman.

Chairman HUIZENGA. The gentlelady's time has expired.

The Chair recognizes the vice chairman of the subcommittee, Mr. Mulvaney of South Carolina, for 5 minutes.

Mr. MULVANEY. I thank the chairman and the ranking member. And I thank Mr. Sheets for being here.

I want to follow up and stay on a topic that the chairman started with towards the end of his questions, which is Greece. Did I hear you correctly, at the end you were asked two questions and you said "yes" to both, but I just want to go back in and make it even more clear, regarding Greece's potential use of the exceptional access funds. You are saying that simply is not going to happen, correct? Did we hear that correctly?

Mr. SHEETS. What was repealed by the IMF, and will not happen, is the systemic exemption. So that in 2010, the IMF was looking at the situation in Greece and there were legitimate questions about the sustainability of the debt, but there was a judgment made that at that point in time making the Greeks restructure their debt would pose significant risks to the rest of Europe, and that was the systemic exemption.

In January of this year, the IMF removed the systemic exemption. So now debt sustainability and whether or not a program is improving the sustainability of a country's debt is very much at the

heart and center of every judgment that the IMF and the IMF board has to make.

Mr. MULVANEY. And the removal of the systemic exemption was something that Congress required of the IMF in the omnibus spending bill at the end of last year, correct?

Mr. SHEETS. The Congress made the phasing out of the systemic exemption a requirement in order for the quota payment to be made. So it was conditional on the quota payment; it wasn't actually a requirement of the IMF. The IMF voted independently of that, but it was necessary for the United States to pay the quota.

Mr. MULVANEY. All right. I have just been handed a note to ask you to clarify between the new language and the way you are going to handle this and the systemic exemption. Is there something that is taking the place of that? Are we just saying now that the only consideration is going to be the debt restructuring and the sustainability of the debt? Is that the only issue that enters into the IMF's mind?

Mr. SHEETS. So, you have debt sustainability and whether or not the program is significantly improving that debt sustainability. Of course, there are important governance issues. Will the country follow the program as written? And is it credible in the commitments? And, frankly, those are the two prongs of what the IMF is now requiring for Greece: one, a solid program that the fund is comfortable will achieve the objectives and the Greeks will follow through on; and two, debt relief to ensure that the debt is sustainable.

Mr. MULVANEY. Correct. Now, you mentioned the relationship with the Greeks and whether or not they will be able to carry out this program. There is some tension between the IMF right now and Greece—and, by the way, rightly so. And I am surprised that the ranking member didn't recognize—hasn't raised this issue. In fact, I don't think many folks on the other side of the aisle have.

One of the questions that we have about the IMF's role in Greece is that it is a developed country, and whether or not you like the IMF, it is supposed to be helping the underdeveloped countries of the world, not Greece, and that every dollar we spend helping Greece is not going to help sub-Saharan Africa. So that is sort of one of the rare bipartisan things that we agree on here.

But let me ask you this. I am going to go into the relationship and I want to ask you about the leaked conversation earlier this month. It was the leaked conversation between the various IMF officials—one in Washington, and two, I think, in Geneva, about the Greek situation. Are you familiar with that situation, Mr. Sheets?

Mr. SHEETS. I have read the news reports, absolutely.

Mr. MULVANEY. Do you know if the IMF has done any investigation as to how that happened?

Mr. SHEETS. I don't know how the IMF has responded internally.

Mr. MULVANEY. Okay. Do we care? We are the largest funder of this. Does the United States Government care how an IMF internal phone conversation got tapped and then leaked? I care.

Mr. SHEETS. That was a confidential conversation between senior people at the IMF. Absolutely, it should have been confidential. As you say, as a shareholder worried about the governance of the institution, we care.

Mr. MULVANEY. Have we done anything to find out how it happened? And here is why I wonder, because the substance of the leaked conversation—someone tapped somebody's phone. and then leaked the transcripts; actually the audio—is that the IMF may have been trying to promote some type of event in Greece prior to the July debt payments that are due in order to spur action. So I am curious as to what—

Mr. SHEETS. The interpretation in the press of the leak, and I think would share this, is that the source of it certainly wasn't the IMF.

Mr. MULVANEY. The source of the leak wasn't the IMF?

Mr. SHEETS. Was not.

Mr. MULVANEY. Okay, that is fine.

Mr. SHEETS. The IMF was underscoring the importance there of, one, the Greeks following through on the program, and two, in order to get the debt relief, the German authorities have been the ones who have been the most reluctant to put that on the table.

Mr. MULVANEY. And you have mentioned that, about—

Mr. SHEETS. Those are the two parties, in some sense, the IMF is negotiating with.

Mr. MULVANEY. And I hope we get a chance to continue this later because you have mentioned that a couple of times, about the importance of debt restructuring. And of course one of the biggest impediments to that is the German intervention, the discussion is they don't want them. But we will maybe continue that a second time.

Mr. SHEETS. I will be happy to speak with you bilaterally about that.

Chairman HUIZENGA. The gentleman's time has expired.

With that, the Chair recognizes Mr. Foster of Illinois for 5 minutes.

Okay, we will, at your discretion.

The Chair recognizes Mr. Himes of Connecticut for 5 minutes.

Mr. HIMES. Thank you, Mr. Chairman. I think we will come back to Mr. Foster.

Mr. Sheets, thanks for being with us. I just wanted to use a little bit of my time or most of my time to go slightly off topic and give you a little bit of time to talk about the Asian Infrastructure Investment Bank. Obviously, we have had something of a stutter-step policy with respect to that bank, and how we have talked about it with our allies, several of whom obviously joined.

I wonder if you could talk a little bit about, from your perspective, what you see that bank doing. In particular, obviously, the criticism and the concern is that it has become an instrument for Chinese policy and strategy. I am wondering if we are seeing that. I am wondering if that is causing tensions within the bank.

And then I wonder if you could comment on how you see it interacting with or perhaps competing with other MDBs in which we have an interest?

Mr. SHEETS. Our view is and has been through the discussion, since the idea of an AIIB was launched, is that the Asian Infrastructure Investment Bank can be a constructive addition to the global infrastructure and to the global community if it adequately incorporates these lessons, these safeguard-like things that I have

alluded to, these lessons of development bank lending over the last 70 years. So appropriate governance structures, awareness of debt sustainability, strong procurement policies, policies on environment and social safeguards, and so on and so forth.

There is certainly a marked infrastructure need in Asia. So to the extent that it is implementing those projects in a way that is consistent with best practice and safe and responsible, it can be a constructive addition.

Mr. HIMES. Do we have any early returns on whether that is occurring?

Mr. SHEETS. We have been very vigorous in our advocacy with that position both with the Chinese directly and with countries that are members. And what we have seen so far is that the documents, the articles of agreement and the documents that have been produced to support the AIIB, are broadly in line with international best practice. So I would say that has been reasonably encouraging.

But I think it is very important that we see how this institution actually operates and we need to see its track record. And one way to achieve that is for the AIIB to do whole co-financing with the Asian Development Bank and the World Bank, and I believe that both of those institutions are exploring options in that regard.

So the AIIB has the potential to be constructive, and we are working through every dimension that we know of exerting leverage to try to ensure that actually is achieved.

Mr. HIMES. Is the Administration giving any consideration to potentially ultimately becoming a shareholder in the bank as a mechanism for achieving that leverage?

Mr. SHEETS. For now, we are focused on meeting the commitments we have to existing institutions. And before any decision like that could be considered, we would need to see a track record, and that still is quite a ways down the road, I think.

Mr. HIMES. Thank you.

I yield back, Mr. Chairman. Thank you.

Chairman HUIZENGA. The gentleman yields back.

With that, the Chair recognizes Mr. Pearce of New Mexico for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

And thank you, Mr. Sheets, for being here.

Following on the line of the questions of the chairman and the vice chairman, I would redirect attention to Argentina. The United States, at the beginning of this year, reversed its stance on making loans in Argentina. Could you explain why that was?

Mr. SHEETS. In December, Argentina had a watershed election where they elected a new government, President Macri. President Macri has made clear that economic reforms are a very important objective. They have taken significant steps to reform their economy, including freeing up the exchange rate and making that more market-determined. Recently, they have concluded a 15-year period of very protracted negotiations with creditors. So the tone of the policy in Argentina has shifted significantly.

In addition, another factor that has been in play is that we had asked Argentina to take steps to normalize its relationship with Paris Club creditors, which we have seen it do.

Mr. PEARCE. One of the key elements appeared to be repayment of loans that they defaulted on. Are they beginning to repay those loans to U.S. investors?

Mr. SHEETS. They are through the Paris Club and, my understanding is, another bit of it was the ICSID awards, which there were outstanding, including to El Paso Energy. And my understanding is that they have taken or are taking steps to clear those arrears as well.

Mr. PEARCE. Are they actually paying those or they are taking steps that might someday lead them to pay them?

Mr. SHEETS. My understanding is that it is happening. It has either happened or is happening.

Mr. PEARCE. It is happening?

Mr. SHEETS. Yes.

Mr. PEARCE. So, again, I think Mr. Mulvaney asked the question properly, for 100 years Argentina was the leading economy in this hemisphere. The United States was second to them. Why are we, when we are supposed to be helping underdeveloped countries, going into countries that have squandered their position, for whatever reasons? Why are we doing that?

Mr. SHEETS. To the extent that the World Bank is involved in Argentina, it would be first of all making loans on a nonconcessional basis. And in general, our thinking is that the World Bank and the MDBs are best placed in middle-income countries to be focused on supporting and helping the poorest.

Mr. PEARCE. So have you rewritten your underlying goals and standards? Because much of your documentation says that you are here to help emerging countries. And if you feel like the best rate of return is on countries, it seems like you out of transparency should realign your goals and realign your mission statement.

Mr. SHEETS. But it is not a one-size-fits-all approach. So what it means to help a middle-income country like Argentina is significantly different than what it means to help a poor country.

Mr. PEARCE. I don't want to get into the nuances of it. I would just say that what your documents say is one thing and what you are describing to me here is completely different. It seems like as a matter of transparency you would want to realign what you tell the taxpayers or us or whoever that you are investing in.

I recently had a conversation—or I didn't have a conversation directly, but a friend of a friend was in the Peace Corps, he is my age and spent his early years in the Peace Corps making investments. So he had a chance to go back after 50 years and look. And he stayed with the Peace Corps, it wasn't like the 2-year stint; he stayed and became one of the managers. And so he went back and he looked 50 years afterwards and he said the projects that we invested in are laying in ruins now.

Do you all ever do, for instance, a 20-year look at where you stuck the world's money, I mean, $100 billion, your budget here, that is a lot of money. Do you ever look 3, 4, 10 years in the past? If we were to take a look at the top 20 projects of 20 years ago, what would we find? Would we find successful, prosperous ventures or would we find those rusting hulks that my friend from the Peace Corps talked about?

Mr. SHEETS. Speaking bluntly, I think we would find a mix. Some projects have been quite successful and others much less successful. And that is very much, it is kind of learning from the past, is what we are trying to do, in thinking about updating, modernizing, and making the governance of these institutions more efficient and to always be drawing on—

Mr. PEARCE. You talk about more efficiency, if you were to compare—and I know I am about out of time—but if you were to compare your investments in renewable energy and oil and gas, would the renewables be more or the oil and gas investments be more?

Mr. SHEETS. I am not sure. I am not sure we have enough track record.

But let me also just say that I think the last 15 years in Argentina have been particularly difficult, that the country has struggled severely. And what you might see in Argentina could be more problematic given their choices, the governance choices they have made, than in other middle-income countries.

Mr. PEARCE. Mr. Chairman, as I close here, I would just make the observation that based on your report, I would guess that the investments in wind energy are probably significantly greater than oil and gas, for instance, and wind energy has about 12 percent effectiveness per dollar. So when you talk about efficiencies, it seems like you would want to be looking at those sorts of rates of return on the investment.

Thank you. I yield back.

Chairman HUIZENGA. The gentleman's time has expired.

Before we go any further, I have a couple of items of business. And in case we have some other Members who are not a part of this subcommittee, without objection, Members of the full Financial Services Committee who are not Members of the subcommittee may participate in today's hearing for the purpose of asking questions of the witness. Without objection, it is so ordered.

And then, I believe the ranking member has a question.

Ms. MOORE. Thank you, Mr. Chairman. I have a unanimous consent request to insert into the record correspondence referenced here at this hearing, April 12, 2016, to Dr. Kim regarding the letter I wrote to the IFC about its conflict policy.

Chairman HUIZENGA. Without objection, it is so ordered.

With that, we will return back to Mr. Foster of Illinois for 5 minutes.

Mr. FOSTER. Thank you, Under Secretary Sheets, and Mr. Chairman.

Let's see, I have a couple of questions. The first has to do with the attitude you take toward transfer unions. A lot of observers have said that the EU is more and more becoming a transfer union where the wealthy economies of Northern Europe, Germany and so on, are being asked to systemically bail out Greece, and other, more southern countries.

I think observers have also mentioned that the United States is becoming much of a transfer union. I know in my State of Illinois, about $40 billion a year leaves the State every year because we pay a lot more in Federal taxes than we get back in Federal spending. The net present value of all the money that has been—wealth that has been transferred out of Illinois in the last 30 years is north of

$1.5 trillion, much larger than the Greek debt, and is a large contributor to the fiscal woes of Illinois.

All of that aside, you face a variety of transfer unions, everything from northern Italy to southern Italy to the different countries in the EU. So how do you handle this and what is your attitude when you are determining need?

Mr. SHEETS. This issue is really at the heart of what it means to be a union in that when you put together a set of somewhat heterogeneous economies, like those in Europe, invariably they are going to be at different places in their business cycles and be experiencing different kinds of economic developments. And it is imperative, if you are only going to have one monetary policy and one exchange rate, that there be some kinds of flows that go from those who are doing relatively well to those that are struggling.

And with the United States, we have very flexible labor markets, and that is one of the key adjustment mechanisms that we have. In Europe, the labor markets are not as flexible, and the way you kind of equilibrate these different parts of the European economy is through transfers from one part to the other.

Where it gets tricky and difficult is if there is a sense that there is a structural notion to it. So it is not just during the business cycle and sometimes one is doing well and sometimes the other is, but that structurally one part of the union is subsidizing the other part of the union. And I think there is that perception in Germany, and that is a true political economy challenge that the Germans face.

On the other hand, if Germany had its own exchange rate, my sense is it would be valued at a different place than the euro is today.

So there are a number of offsetting macroeconomic considerations. But these transfers that you highlight and their sustainability is really linked to the sustainability of a union.

Mr. FOSTER. Well, thank you.

Another effort where you have considerable leverage is just in reducing corruption. I think the Economist magazine is a big fan of the single most effective intervention we can do is just to discourage corruption wherever we can.

So when you look at the distribution of your efforts, how do you rank that? And do you think you spend enough of your time trying to fix the corruption problem in developing countries?

Mr. SHEETS. I very much agree that if there is corruption—and this may be one the lessons of development lending over the last 70 years—where there is corruption it becomes essentially impossible for development policy to work. The resources don't get to those who need them the most.

And so I would say not only would it be high, it would be an indispensable ingredient of a successful development strategy. I know that it is one that the multilateral development banks and the IMF put a very, very high weight on.

Mr. FOSTER. Are there initiatives, specific initiatives that would really improve the effectiveness that have been identified or just successful experiments in making the finances of all of the players who are involved in corruption more transparent?

Mr. SHEETS. There are various case studies and approaches that have been used, some to address low-level kind of petty sorts of "petty corruption issues," others from a more high level. I think that the more high-level stuff is probably more legal, and legal enforcement and toughening that up. The petty stuff is more systemic and you have to think about what incentives and wages and so on and forth are being paid to the civil service.

And then there is a related issue of tax compliance and making sure that the people who owe tax actually pay tax, and there are a number of countries around the world where that is an issue.

So those are some of the things that I reflect on when you raise the issue of corruption. And all of them are necessary.

I guess another one that is particularly important for the Treasury is that we are engaged all over the world on AML/CFT technical assistance and ensuring that the financial sector is free of abuse—

Mr. FOSTER. I guess my time is up. I will yield back.

Mr. SHEETS. Yes, that is also another important thing. It manifests itself in many different ways and must be fought in all those different dimensions.

Chairman HUIZENGA. The gentleman's time has expired.

The Chair recognizes Mr. Pittenger of North Carolina for 5 minutes.

Mr. PITTENGER. Thank you, Mr. Chairman.

Mr. Sheets, I appreciate this dialogue. I would like to follow up on Mr. Foster's inquiries.

In reference to operation in countries that are complicit relative to human rights and corruption, last year the Financing for Development Conference took place in Ethiopia, which ranks 103rd on the Transparency International corruption index and is also rated by Freedom House as not free. How do you make the connection between that and your reference that it would not make good judgment to be providing this type of resource to the country that was complicit with corruption?

Mr. SHEETS. This is an important and a challenging endeavor in that there are 185 countries in the world, all of them at different places. And I think that the important thing is that we engage with these countries and do what we can to help, wherever they rank on that, that we are doing what we can to help move them up, at least in terms of their practices. I guess everyone can't move up simultaneously in a relative ranking, but everyone can move up simultaneously in terms of absolute standards and their expectations in fighting corruption.

Mr. PITTENGER. Mr. Sheets, with all due respect, aren't you really setting this country up as a qualified country, as one that would be acceptable by coming and honoring them in the presence of having your meeting there? I think to me it says to the rest of the world that those standards are highly flexible.

Mr. SHEETS. Yes, I think it is—and certainly this would be true for Ethiopia—that we think of this as a process of hiking and working with them to press forward—

Mr. PITTENGER. I think the higher you keep your standards in—

Mr. SHEETS. —I am not saying that anybody's perfect where they are today.

Mr. PITTENGER. —you are giving a visual to the rest of the world of what you believe is acceptable. And it seems to me if what you are saying is correct, that you want to support countries that do not tolerate corruption, that don't tolerate human rights abuses, that we should honor those who are doing it the right way.

As you look at—on another issue—given the turbulent economic trends and issues that we see in China and Russia and Brazil, do you believe that they are sustainable in terms of their engagement with AIIB and also with the BRICS? Are they going to be a valid player in the market?

Mr. SHEETS. When we think of the BRICS, this is a period of greater economic uncertainty, I would say, for the BRICS than was the case, say, a decade ago. Brazil's economy is facing some significant challenges. Russia's economy, clearly, for a number of reasons is facing significant challenges. South Africa is feeling the effects of much lower commodity prices. And the Chinese economy is gradually slowing, which I would say is a moderation and not unexpected. No economy is going to grow as fast as China was growing. But it is a slower pace of growth. Of those BRICS, I would say the one notable exception is India, where it continues to grow at something over 7 percent.

In terms of the specific association amongst them, they are five of the leading developing, emerging markets economies of the world. And I think from that perspective, they have some common interests, but more broadly, they also are very heterogeneous.

Mr. PITTENGER. I appreciate your perspective.

One more question. I am short on time. A follow-up to Mr. Pearce. The data that I received shows that 65 percent of NADR's portfolio went to wind and solar energy efforts. So there seems to be some data out there to support that.

What process is used to decide which projects deserve financing over others? And I can also look at what you have done in terms of the border States. Texas has gotten—area has gotten a substantial amount, where Arizona has not, neither has New Mexico.

So what standards do you use to provide these types of outcomes?

Mr. SHEETS. And which portfolio was 65 percent wind and solar?

Mr. PITTENGER. The NADR's portfolio.

Mr. SHEETS. Got it.

So the NAD Bank's mandate is to invest in environmental infrastructure. And the question that would be asked of the projects, be they wind, solar energy, or waste management, roads, sanitary, et cetera, et cetera, is what is their development impact, what is the bang for the buck, so to speak.

Mr. PITTENGER. Thank you. My time has expired.

Chairman HUIZENGA. The gentleman's time has expired.

The Chair recognizes Mr. Heck of Washington for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

Under Secretary Sheets, thank you so much for being here.

One of my favorite adages is as follows: Not everything that counts can be measured and not everything that can be measured counts.

Despite the fact that is one of my favorite adages, I, in fact, conduct my life in a way that seeks to do exactly that. Informed most-

ly by my time in the business sector, I think it is important to be intentional, to decide what success looks like, and to attempt to measure it. And accordingly, I was heartened to see you say in your testimony that the MDBs must measure success by the outcomes of projects, rather than the amount of financing provided.

So, Under Secretary Sheets, could you give a little color to what outcomes you seek to measure, what success looks like, what are you trying to incentivize, and what the metrics are?

Mr. SHEETS. I also very much like that quote, and as an economist argue I have spent my life in other pursuits as well.

Mr. HECK. My second favorite adage is, if you could take all the economists of the world and lay them end to end, it would be a good thing.

Mr. SHEETS. And one of my great frustrations is I only have two hands. Often, I wish I had three.

But in terms of what we are measuring, again, it is development impact. So what is the implication of these projects in the lives of real people? And that can be some of these disadvantaged populations that Representative Moore has highlighted.

It is also the business communities. How are they helping to facilitate small and medium-sized enterprise development and a business climate in these countries that is supportive and helpful?

And then, there is a whole set of issues about the global commons that I mentioned. Are we delivering global public goods?

And as you think about that on a country level, then it aggregates up into, what are the implications of these policies for the global economy, for global growth, for the global environment, for global poverty reduction, and then ultimately to the United States, in U.S. growth and U.S. employment?

So I think of it as in some sense an escalating set of issues of rising generality. But in the first instance we have to say what does this mean for individual people inside the countries where the project is being done?

Mr. HECK. GDP growth, small business growth, income growth, business climate as measured.

Mr. SHEETS. Poverty reduction.

Mr. HIMES. Poverty alleviation.

So, Under Secretary, you have often warned about the potential negative impacts on U.S. global leadership if we don't stay in the game, if we don't meet our obligations or our commitments to participate in the international financial institutions.

Putting this in a broader context, I think about the seeds of the MDBs being sown at Bretton Woods, and especially when combined with the Marshall Plan. We were hugely motivated just in part by altruism, but also we were seeking to avoid warfare. And I think that was one of the hard lessons between World War I and World War II. We were also seeking to do all the things you just talked about in order to create markets for our own goods.

And I guess what I want you to talk about is why it is in our self-interest—leave altruism aside for the time being—why is it in our self-interest to pursue participation, robust participation in international financing institutions?

Mr. SHEETS. I think you made many of the arguments quite candidly there. Ultimately, what the international financial institu-

tions are about, is developing strong, stable, economically and militarily, economically stable and secure, countries around the world. And as we see that achieved, that means more opportunities for U.S. exporters. It means more U.S. jobs. It means stronger global growth. It means more opportunities for U.S. investment.

I think the MDBs' track record over the last 70 years is that they have contributed to these kinds of things, global stability, global growth, and rising opportunity for people around the world, which in turn, creates rising opportunities, rising demand, and opportunities in the United States.

Mr. HECK. And it is, therefore, in our self-interest, sir?

Mr. SHEETS. Strongly. And let me, consistent with that, just say, that since the IMF quota money was paid to the IMF, our ability to be able to influence that institution in a way that is consistent with U.S. objectives has been greatly enhanced. So it is a concrete example of what you are speaking about.

Mr. HECK. Sure.

Chairman HUIZENGA. The gentleman's time has expired.

The Chair recognizes Mrs. Love of Utah for 5 minutes.

Mrs. LOVE. Mr. Sheets, thank you for being here.

Many assume that the MDBs are poverty-fighting institutions. And even though their nonconcessional lending to middle-income countries can equal or exceed loans to poor governments, it was reported this month that the IBRD, the World Bank lending arm to the middle-income countries, is expected to have a banner year, pushing $25 to $30 billion out the door at levels unseen since the financial crisis.

So by definition, a nonconcessional borrower at the MDBs is more creditworthy than poor countries borrowing from a soft loan window. Mr. Sheets, in your thoughts, why should taxpayers guarantee loans to countries that have access to capital markets anyway?

Mr. SHEETS. This is a very, very important question. First of all, let me emphasize that the terms that are extended to middle-income countries by the MDBs are different than those that are extended to poor countries by the MDBs. The MDBs' interactions with the poor countries are more likely to have a significant grant element to them, so just an outright passing of resources, and would be given at a lower interest rate than would be the case for middle-income countries.

In terms of the case for lending to middle-income countries, my sense is that even in these middle-income countries, they have significant fractions of those who are still in poverty. And focusing lending on the poorest in these countries is something that is of great importance.

Mrs. LOVE. Okay. So first of all, to the first point you were making, we are still pushing $25 to $30 billion out the door.

Mr. SHEETS. Yes.

Mrs. LOVE. In terms of sheer numbers, that is one.

Mr. SHEETS. Yes. Yes, substantially.

Mrs. LOVE. But also, I have heard the argument already that—I have heard this argument about the different areas in some of these larger countries that—

Mr. SHEETS. Yes.

Mrs. LOVE. —that are experiencing extreme poverty. But it essentially means that China, India, and other large countries that still have many citizens who are living in extreme poverty, you have to understand that, to us, we understand what is going on there. China and India have ample resources that can benefit their own citizens.

For instance, China still has over $3 trillion in reserves and has itself established not just one but two development banks. So again, I have heard that—I need to have some sort of other reason, because like my colleague said, every dollar that we spend in some of these countries is a dollar that we are not spending in countries that may need those resources.

Mr. SHEETS. Specifically, with the case of China, but others as well, as I indicated in my remarks, we are vigorously engaged with these countries, emphasizing to them what their responsibilities are in the global system. And last summer, as we were negotiating with the Chinese in the run up to the summit between President Xi and President Obama, one of the key deliverables that we achieved with the Chinese was them making a commitment that over time they would increasingly be contributors to these institutions and decreasingly be using them.

But you know, by the same token, as I said, my sense is there are tens of millions of poor people in China. When the MDBs come, that they bring international best practice, there is learning by doing in a number of different dimensions. So I think there is a case for the MDBs being in the middle-income countries, but it is also important, as they have resources, that they become contributors and that they taper off their borrowing.

Mrs. LOVE. Do you have a specific matrix or any set criteria for evaluating when a middle-income country no longer needs multilateral development assistance?

Mr. SHEETS. That is actually a vigorous debate inside of these institutions that is under the rubric of graduation: When should countries graduate from being borrowers at the MDBs? And there is a whole—

Mrs. LOVE. I would think that would actually be a priority, especially because—

Mr. SHEETS. Absolutely.

Mrs. LOVE. —like I said, we have taxpayer dollars going into—

Mr. SHEETS. Absolutely.

Mrs. LOVE. We have to be able justify.

Mr. SHEETS. Yes, we have been strong advocates of graduation when that is appropriate.

Mrs. LOVE. Thank you.

Chairman HUIZENGA. The gentlelady yields back.

Mrs. LOVE. All 4 seconds.

Chairman HUIZENGA. All 4 seconds, yes. Very generous of you. We appreciate your efficiency.

With that, we recognize the gentleman from Michigan, Mr. Kildee, for 5 minutes.

Mr. KILDEE. Thank you, Mr. Chairman. And Mr. Sheets, thank you for your testimony, and I apologize. I just came in. If some of these questions—I really have only two areas I want to explore, if they have already covered them.

But if I could ask you to comment on some research that we have seen which shows that investing in the education of young women and girls has an incredible rate of return. Talk to me about the extent to which MDBs are focused on that particular question, especially in light of real questions about economic growth actually being dragged down by the lack of full participation of populations in local economies, especially in developing parts of the world, and what levers, what tools can be used to ensure gender equality when it comes to access first to education but then to other aspects of a nation's economy.

Mr. SHEETS. I very much share your view, and I think that institutionally, the Treasury shares the view that education and encouraging strong education around the world is absolutely crucial. It is a key part of the development process, raising the expertise in the human capital of the public.

We would further categorically agree with you that bringing women and girls into the education system and in the labor force is absolutely essential. We can look around the world and see countries that are quite advanced, as well as countries that are not advanced at all economically, that are not adequately using the capacities and the employment capabilities of women. And it is imperative, especially as we think about an aging global demographic, that women have opportunities in the labor force completely and fully.

Now, consistent with what I am saying, education, particularly education of women and girls, is a key priority of the MDBs. It was one of the key priorities of the Financing for Development conference that was held last summer. It is at the center of the work programs in all of the MDBs. It is something that all of them are committed to achieving. Maintaining adequate resources for that is important.

There is also another aspect of it, and that is a safeguards aspect of making sure that as projects are implemented, this objective of bringing in and allowing a fair participation, regardless of gender in projects, and that people are protected, that is also an important aspect of it as well.

Mr. KILDEE. Thank you. And just switching gears, I wonder if you could make any comments on the challenges, particularly in developing countries, regarding clean drinking water?

I have a particular interest in the subject. I represent Flint, Michigan. I am often looking for some corollaries between the global challenges we face, and sadly, some of the unique challenges that we face in really distressed communities in our own country. But could you comment on the extent to which MDBs have been able to focus on the development of drinking water systems that don't absolutely have to have a market basis in order to be sustained? That is one of the big challenges, particularly in areas of high poverty.

Mr. SHEETS. This is also of great importance. I think that Representative Moore referred to access to water as being a human right, and I very much share that view.

Water projects, sanitation projects, et cetera, et cetera, are core to the MDBs, and in fact, when I think about the restructuring that Jim Kim did at the World Bank where he reorganized the

bank from focusing on regions to focusing on practice areas and areas of emphasis, one of those core areas that he is focused on is water and ensuring access and management and sanitation, and so on and so forth.

The other point that I would make is I think the North American Development Bank, its mission of environmental infrastructure along the U.S.-Mexican border is also very relevant here of ensuring adequate access to water and sanitation and so forth in all parts of the United States.

So I think there are a number of different dimensions here, and they are very important.

Mr. KILDEE. Thank you very much. I see my time has expired. I thank the chairman and the ranking member for this hearing and I yield back my time.

Chairman HUIZENGA. The chairman appreciates your just self-policing there on your time.

The Chair recognizes Mr. Schweikert of Arizona for 5 minutes.

Mr. SCHWEIKERT. Thank you, Mr. Chairman.

Dr. Sheets, I have a whole series of quick questions just for education dialogue.

What is the most successful practice you believe that you have seen different development banks engage in to deal with corruption?

Mr. SHEETS. I think what we are seeing in the AML/CFT space right now is quite extraordinary, and the MDBs are working on it. We at Treasury have taken at look at this.

Mr. SCHWEIKERT. Describe to me what the practice is.

Mr. SHEETS. The MDBs have technical assistance that is similar. Let me describe what we are doing in the space; it is similar. We have projects in 17 countries, and many other countries have requested it, where we send in teams of specialists who know bank supervision and how to root out unsavory transactions and sit down with their counterparts in developing countries and teach them how to do it, so it is really a hands-on technology transfer.

Mr. SCHWEIKERT. Okay.

Mr. SHEETS. And I think that is the key, and you need to be hands on. You can't just pass a handbook. It has to be—

Mr. SCHWEIKERT. And with that, going in the right direction, would you oppose, as we are getting ready to recapitalize and try to make sure we are doing things the right way, to also put in sort of the bad actor provisions, that these individuals cannot touch the money?

Mr. SHEETS. That bad actors, along with the AML/CFT, that bad actors—

Mr. SCHWEIKERT. We have our classic examples of some of the assistance to Ukraine, and we know that certain folks managing the money are the very people whom we are also investigating for having done something dodgy.

Mr. SHEETS. Absolutely. In the Ukraine, as we have interacted with them in the contexts of the IMF program and also the loan guarantee—

Mr. SCHWEIKERT. And I was just using them as an example.

Mr. SHEETS. Yes.

Mr. SCHWEIKERT. It has been—

Mr. SHEETS. We have been emphatic about—

Mr. SCHWEIKERT. —a worldwide phenomena.

Mr. SHEETS. —fighting corruption and making sure the bad actors aren't the ones who are in the position of applying the rules.

Mr. SCHWEIKERT. In some of the literature, there is discussion about also trying to design the system so it is direct payments to contractors instead of it flowing through the partner country, that payment goes directly to the concrete company that delivered the concrete, all those sorts of things. Almost like if you were doing a development—let's say you were building some condos here or something of that nature, your bank, on occasion, would pay directly to your individual trades or contractors.

Mr. SHEETS. Yes.

Mr. SCHWEIKERT. Is that comfortable?

Mr. SHEETS. I think the empirical literature on this suggests that to the extent you can make the payment directly to the source and cut out various administrative layers, unsurprisingly, that gives you much better results.

Mr. SCHWEIKERT. Okay. So we have already come up with like two or three—

Mr. SHEETS. Yes.

Mr. SCHWEIKERT. —at least conceptual reforms that we both like.

Last one, and this one is a little more ethereal, but I think has a much grander scheme. There are a number of us here who have been talking about, for a couple of years, and—the idea of one of the most powerful things we could ever do in development aid is actually how do you get the money down to the population who is in most need of—is most in the categories of poverty?

Okay. We have all seen the—we all grew up hearing the stories of the micro-lending in Bangladesh and those things. I am talking the next level where I have, even some of my poorest populations, walking around with some versions of smartphones where the smartphone is also their bank. How I do basically—I will use the term "eBay" or trade, and how do we use both the combination of technology and our resources to build that platform?

So if I am here in North America and I go online and there is a small village in the middle of Myanmar that carves tables, that I can buy that directly from them, use this technology to send the money directly to them without the graft, baksheesh, whatever you want to call it, being skimmed off the top or huge portions of it disappearing, and that sort of bilateral trade with the folks in most need of it using our current technology. What do you believe your agency and organization would be willing to do to help us bring that about?

Mr. SHEETS. One frame on that is how to build micro-nationals around the world. One place where we have seen this happening, and where the Treasury and the MDBs have been involved, is in India where the population has hundreds of millions of cellphones, and they are using those cellphones to connect into the financial system and to enhance financial inclusion.

Mr. SCHWEIKERT. Mr. Chairman, I know I am out of time, but those four things, the three about corruption and the one about sort of the resources also going directly to the folks we intend to help by trading with them, and building a platform to do that,

those are all ideas I would like to present to you in writing at some point. Thank you, Mr. Chairman.

Chairman HUIZENGA. We appreciate that. And if it is all right with you, Secretary Sheets, the ranking member and I have discussed doing a brief second round as well, which may just consist of a couple of us, but I had a couple of follow-up questions, and we want to be mindful of your time as well.

But with that, pursuant to our rules when we don't have anybody on the other side of the aisle present, we will go to the next person on the Majority side, Mr. Emmer from Minnesota.

Mr. EMMER. Thank you, Mr. Chairman. Thanks for holding this hearing, and thank you to the Under Secretary for joining us this morning.

We are here today, as I understand it, to discuss the World Bank and the four regional MDBs because the Treasury is currently negotiating a replenishment of the World Bank and the African Development Bank. And the term "replenishment" is really another way of saying what Americans are being asked to contribute. Isn't that correct?

Mr. SHEETS. Yes.

Mr. EMMER. And there is a paid-in amount and then there is an overall commitment, correct?

Mr. SHEETS. There are two modalities through which these contributions are made. One is through capital increase, which would be the called in, but there are also in the concessional windows that are used to support the poor.

Mr. EMMER. If I can interrupt, Mr. Sheets. I understand—

Mr. SHEETS. Though we make contributions directly.

Mr. EMMER. That is not where I am going. I am just asking, if it is not true that we have a paid-in amount that the United States will actually deliver in cash—

Mr. SHEETS. Right.

Mr. EMMER. Where it goes, I am not concerned right now. And then there is an overall commitment, the number that we have capital-on-call, if you will, correct?

Mr. SHEETS. Yes. I was just saying, particularly at the World Bank, I think of it as two accounts. The GCI, the paid-in capital requirement to the balance sheet, that is not on the table now. Now we have the IDA, which will go to support the poorest through concessional lending and grants.

Mr. EMMER. And I appreciate the clarification. For the past 3 years, because my understanding is now every 3 years we have to do this, and let's just talk about the World Bank, what was the overall amount paid in by the United States as opposed to what was the overall commitment?

Mr. SHEETS. So my recollection—do we have that number? Okay. So the overall replenishment for IDA 3 years ago was $52 billion.

Mr. EMMER. Okay.

Mr. SHEETS. And the United States paid in $3.9 billion, and these were payments to the concessional window for the poorest.

Mr. EMMER. Got it. So now we are talking about the next 3 years. Treasury is proposing what for the paid-in amount, the overall commitment? Let's do it the other way.

Mr. SHEETS. We are now in vigorous negotiations with foreign counterparts as to where this thing might land. My instinct is that the next replenishment is going to look broadly similar in terms of size to where we were before.

Mr. EMMER. All right. Now two of the goals of the World Bank are: one, end extreme poverty; and two, push for greater equity. I think that as part of the goal of ending poverty in underdeveloped and developing countries, to lift their standard of living around the globe, the World Bank, the idea is, it facilitates the availability of capital to deploy on projects that these underdeveloped and developing countries can use to develop, for instance, their transportation infrastructure, correct?

Mr. SHEETS. Absolutely.

Mr. EMMER. And their water and sewer infrastructure, their energy infrastructure, their communication infrastructure, all of these things, right?

Mr. SHEETS. All of the above.

Mr. EMMER. And as I was reading it conceptually, my colleague from Michigan earlier talked about the important foreign policy considerations of making sure that we have stable countries around the globe, that their standard of living is rising not only so that they can trade with the United States and others but so we can develop a relationship that perhaps doesn't lead to conflict down the road. That is one of the purposes.

Mr. SHEETS. Yes, exactly.

Mr. EMMER. But it is also to an advance, isn't it—it is also a part of what the Administration, whomever is in charge, uses to advance their global agenda, isn't it?

Mr. SHEETS. There are policy judgments that are made.

Mr. EMMER. And let's talk about that quickly because in the time I have left, the loans that are being made, whether they are to middle-income countries or to those that need the help in the concessional window, the loans aren't just based on an ability to pay and a plan as to how to pay. The World Bank makes a decision as to whether or not this project is worthy based on social considerations as well as an ability to pay?

Mr. SHEETS. Yes. I will say, inevitably, there is a prioritization—

Mr. EMMER. Let me—

Mr. SHEETS. —of the project.

Mr. EMMER. I will be very specific. My understanding is that the World Bank will not facilitate financing for a hydro-electric development in a developing nation at this point.

Mr. SHEETS. I have no basis to—as far as I know, that it can.

Mr. EMMER. It can.

Mr. SHEETS. Yes. Why I—

Mr. EMMER. That isn't the point. It can. They can do a lot of things.

Mr. SHEETS. They can.

Mr. EMMER. But my point is, there has been a decision made somewhere that it will not facilitate loans for hydro-electric development.

Mr. SHEETS. The Power Africa is about bringing all various kinds of power into Africa.

Mr. EMMER. I see my time has expired. If we can just do this, Mr. Under Secretary—

Mr. SHEETS. Yes.

Mr. EMMER. —going forward, can I get with your office and get a list?

Mr. SHEETS. Yes.

Mr. EMMER. Somewhere, it has to be written down.

Mr. SHEETS. Yes.

Mr. EMMER. What is appropriate, what is not.

Mr. SHEETS. Yes. And I would be happy to chat with you offline as well.

Mr. EMMER. Thank you.

Mr. SHEETS. Thanks for your questions.

Mr. EMMER. Thank you.

Chairman HUIZENGA. The gentleman's time has expired. I will remind the gentleman that he can also submit written questions to the Chair, and we will forward those on and be able to get some of those answers on the record that would probably be illuminating for everybody.

Mr. EMMER. Thank you, Mr. Chairman.

Chairman HUIZENGA. Without objection, we are going to move to a second round of questioning. And with that, the Chair recognizes the ranking member for 5 minutes.

Ms. MOORE. Thank you so much, Mr. Chairman. And thank you for your indulgence and patience with us, Under Secretary Sheets.

I don't want to belabor the point here, but we have talked a lot about accountability and transparency at these institutions, and I am wondering—and I know that I am very impressed with the fact that we have been able to get some sort of cooperation among and between these multi-development banks.

But I am wondering, are we able to sort of export our concerns about corruption and so on to these other banks? To the extent that they are independent but they have carved out their separate roles for development in their regions, to what extent are we able to enforce safeguards and transparency among the banks? What is that mechanism?

Mr. SHEETS. We are the largest shareholder in the World Bank, but we are also the largest shareholder in all of the regional development banks, with the exception of the African Development Bank where Nigeria is number one and we are number two.

Ms. MOORE. What about the Asian Development Bank?

Mr. SHEETS. In the Asian Development Bank, we and the Japanese have the same share, so we are co-largest in that institution. So we are a very significant voice in the boards of all of those institutions, and in all of those institutions, we vigorously advocate for the kinds of things that we talked about today.

And as a result of our advocacy and through the choice of leadership of the institutions, I think we have been quite effective in raising this as a key goal for these institutions to achieve. Of course, there is always work to be done to achieve the goal more effectively, but—

Ms. MOORE. What about BRICS?

Mr. SHEETS. What is that?

Ms. MOORE. The BRICS.

Mr. SHEETS. The BRICS bank.

Ms. MOORE. The BRICS multi-development bank across countries.

Mr. SHEETS. With the BRICS bank, the key shareholders are Brazil, Russia, India, China, and South Africa, and that is a new institution that they have recently established. There our influence has to be more indirect, and it is a matter of engaging with that institution and with those countries and encouraging them to pursue these policies.

The BRICS bank hasn't made any loans yet, so it is too early to say whether or not they will follow these practices, but my sense is that these practices are good policy and the case for them is very strong, so we will continue to persuade them to follow it.

Ms. MOORE. Good. Are we anticipating participating in loans with BRICS funds?

Mr. SHEETS. As the BRICS banks have acceptable loans, I think that the MDBs would consider that. But I would say, given the more limited shareholdership in that institution, that is somewhat less likely than co-financing with the AIIB where many more countries around the world are actually members.

Ms. MOORE. We should watch this very carefully.

Mr. SHEETS. Indeed, yes, we are.

Ms. MOORE. Okay. Thank you. I yield back.

Chairman HUIZENGA. The gentlelady yields back. The Chair now recognizes himself for 5 minutes as we wrap this up.

Under Secretary Sheets, on page two of your written testimony, you talk about the NADB bank and how it is unique, and at the end of that first paragraph say that, "The NADB bank's financing of projects in areas like wastewater collection and treatment, solid waste management, and air quality improvement enhance the quality of life and protect the environment and communities on both sides of the border."

There is, however, evidence in a chart in front of me here that two-thirds of the financing of the NADB bank is in wind and solar, and I think that goes back to my colleague, Mr. Pittenger's, question, and being from Michigan as well, and my mother being from Flint originally, I am very concerned about what has been happening with Flint, and what Mr. Kildee was talking about, and it seems to me that maybe NADB bank has really pulled itself off of its core intent, wastewater collection and treatment, solid waste management, air quality improvement.

And as I recall with NAFTA passing early in the Clinton Administration, that was a major, major concern, that you were going to have companies shifting across the border and then having all of their environmental regulations taken off, a shared watershed along the Rio Grande, that things were just going to be dumped in there, and the idea of the NADB bank was to be going in and making sure that there was the infrastructure, whether it is drinking water or sanitation, roads, all of those different things, not two-thirds of its portfolio in solar and wind power.

And so I think it begs the question now, aren't they pulling those dollars away from some of that vital infrastructure that Mr. Kildee was talking about?

Mr. SHEETS. My understanding is that they are operating consistent with their mandate, which is environmental infrastructure. Part of that is ensuring reliable power sources.

Chairman HUIZENGA. Would you acknowledge that is maybe a little broader definition of what environmental infrastructure might be than it was in 1993, I guess it was, when this was passed? We didn't have massive wind farms envisioned at that point.

Mr. SHEETS. Right. But I would think that it would include, on the one hand, ensuring sustainable energy for the region and also ensuring reliable energy for the region. But as you said, these other functions of water and sanitation and roads and so on and so forth are also of great importance.

Chairman HUIZENGA. Okay. And I want to, in the last remaining 2 minutes here, hit on the BRICS banks and the AIIB as well. And I am very concerned and curious, will the Asian Infrastructure Investment Bank and BRICS bank hold borrowers to the same standards that these other MDBs, and transparency? Give me a comment on that.

And then, given the turbulent economic state of China, Brazil, Russia, you name it, with what is happening there, what is their impact at this point?

Mr. SHEETS. On the AIIB and holding borrowers to the same standards, that is the core, the crux of our engagement with the Chinese on this issue is pressing for approaches and lender modalities that are consistent with these best practices that we have discussed in this hearing.

Chairman HUIZENGA. Is there any reason to believe, though, that they are going to follow through on that? Much like they don't adhere to our standards on their own air pollution standards, for example.

Mr. SHEETS. The written documents that have been produced are broadly consistent with international best practice, so I would say that is a positive. And there were countries, and we are working with them as well, who are members of the AIIB who are pushing. So we are pushing the Chinese directly. We are also working with those that are members to push on the board.

And then a third modality to achieve this outcome is for them to co-finance with the MDBs in the sense that, as they are getting coming together and doing projects jointly, they inherit all of these safeguards and practices that we described. But this is a key issue. We are watching it very closely, and we will continue to emphasize to the Chinese the necessity of following through.

I guess one other point here that is material to your question is during the summit in September between President Xi and President Obama, the Chinese committed to ensure that the practices of the AIIB would be consistent with best standards.

Chairman HUIZENGA. With that, my time has expired.

And we would like to welcome Mr. Meeks of New York here for round two, and I think he will be our final questioner. So with that, the Chair recognizes Mr. Meeks from New York for 5 minutes.

Mr. MEEKS. I thank the chairman and the ranking member.

Mr. Sheets, good morning to you. I have been watching and working with, and following the work of the MDBs for awhile, being on this committee for a long period of time, longer than I care to think about. And I have no doubt in my mind that their mission is absolutely essential for combating poverty and for the most vulnerable regions, and that is absolutely essential for our own national interests, both economically and for our security.

But I am not sure if they are doing enough and that institutions like the IMF and the World Bank have the capacity to do enough to drastically reduce poverty. The World Bank and other MDBs are currently looking for ways to leverage the equity from their concession window so they can do more in terms of grants and concessional loans, and I support these initiatives. But I want to make sure that greater concessional support would be accompanied by better governance.

I think that not just at the project level but also at the country level. And what I want to do is so that we can set an example so that if they—you see better governance happening, other countries can see that if you do better, then the likelihood of them getting the support would be great.

And that will help and have a huge impact in reducing poverty. So I was wondering if you could give me a comment on that?

Mr. SHEETS. I broadly agree with your assessment. First, it is important for us to continue to think of ways to better utilize and leverage the resources of these institutions, particularly with an eye to continuing to meet the needs of the poorest countries.

As we discussed earlier, we have seen that achieved with some success at the Asian Development Bank, and there is now a process ongoing at the World Bank thinking about how to better to deploy the IDA resources and how those resources might be better used to meet the needs of both developing and other countries.

The other part of your question, I think, very much cuts to the importance of safeguards and ensuring that the lending processes are high quality and incorporating the experience of the past. And not only that we articulate that up front as being important but that actually, once these projects are in place and completed, that resources be allocated to ensure that the safeguards have been followed so that there is a focus not only on articulating good safeguards but on implementing them and monitoring them after the fact, and make sure that the countries that are involved, the companies that are involved, the workers and so on and so forth that are involved, are following through on those best practices.

Because as you say, the countries that are following through and implementing are the ones that should be rewarded with additional financing and should be given priority. I have talked about this prioritization process. And in some sense you have to prioritize across sectors. You also have to prioritize across countries. And those countries that are following through and engaged are the ones that should be given priority for more funding going forward.

Mr. MEEKS. All right. I concur with you.

Let me also add, Director Lagarde has recently been very clear that her institution at the IMF lacks the resources to respond to potential emerging market debt crises, which is now an emerging

risk in the face of the commodities prices slump and currencies devaluations that we have seen across many of the regions.

She has called, for example, for currency swap lines with central banks, and for credit lines with the MDB, so that developing countries can reallocate some of their foreign reserves to local investments. And I was just wondering, has the Treasury looked into this request at all?

Mr. SHEETS. Our sense is that with the passage of the quota reforms, and they were agreed to in 2010 and then recently completed this year, the IMF is well-resourced and is in a position where it is able and should be able respond to the challenges that emerging markets in developing countries face.

Now, in addition to the discussion of the size of the IMF's balance sheet, there is also a discussion of what is being called "global financial safety nets," so is there some way to provide an additional kind of backstop for emerging market economies to, or in developing countries, to give them liquidity during a time of stress? The IMF provides some of that through its flexible credit lines or FCL, but is there some way, working together, the international community can provide additional support?

My sense is that, to date, those discussions are very preliminary, and we haven't yet seen a way forward that makes sense.

Mr. MEEKS. Thank you.

Chairman HUIZENGA. The gentleman's time has expired, and we welcome an additional member of the committee here, Mr. Hinojosa of Texas, for 5 minutes.

Mr. HINOJOSA. Thank you, Chairman Huizenga, and Ranking Member Moore. Forgive me.

Chairman HUIZENGA. Please proceed.

Mr. HINOJOSA. I want to thank you and Ranking Member Moore for holding this hearing on development banks. I can say that today's schedule is extremely packed, and I have been at two other hearings where I just had to speak because I had some bills there.

I want to take this opportunity to ask a question that is on a subject that involves the bank that I am so interested in, so I could say that over the history of the NADB bank located in San Antonio and serving Mexico and the United States has financed 218 projects, with only 26 in the area of renewable energy, including wind and solar, which is a slight 11 percent.

In fact, over the last 5 years, 41 of those projects have been completed in the area of water and wastewater, while only 18 clean and renewable projects have been completed. Few, if any, have that record that I just read to you, but the benefits that are being received by the constituents on my side of the Texas congressional district, and then of course the people from Mexico where these projects were done, have improved quality of life in a way that is easy to see and appreciate.

My question is, how does NADB bank financing renewable projects help the bank accomplish its mission, as well as produce economic development and opportunity for the impoverished communities along the United States-Mexico border?

Mr. SHEETS. We very much share the assessment of the NADB bank that you articulated, that it has been a powerful source of development along both sides of the border and that there is clear

additionality here with this institution that is able to do projects in the United States as well as in Mexico and work directly with municipalities and so forth in ways that the other MDBs would not be able to do.

Now, consistent with the mandate for environmental infrastructure, it is, as you indicate, very important to focus on water and sanitation and roads and so on and so forth along the border, but also sustainable, reliable sources of energy are a very important objective in the economic development of that region. So that is how we would see that fitting into that broader mandate.

Mr. HINOJOSA. Dr. Sheets, how is the NADB bank accountable to the United States for our portion?

Mr. SHEETS. We, along with the Mexican Government—the U.S. Government and the Mexican Government are the shareholders, so we would be on the board of those institutions and manage them.

Mr. HINOJOSA. The monies that are used at NADB bank are put in, half from the United States, and half from the Mexican government?

Mr. SHEETS. Correct.

Mr. HINOJOSA. I have been talking to friends on both sides of the aisle, and they seem to be very impressed with the quality of the projects and the success that they have had, how they have benefitted, and so we have asked for an increase so that it will be $6 million, half and half, both governments.

Do you support that?

Mr. SHEETS. Very much so. This capital increase would allow the NADB bank to continue to lend at a pace of $200 to $250 million a year, which is essentially where it has been in recent years. Our sense is that the demand along the border is quite substantial, and the need there is significant.

Also, as you indicate, our counterparts in Mexico look at this as a very important signal of our bilateral commitment and the capacity of the two governments to work together, which is something that we see as being very important.

Mr. HINOJOSA. I appreciate that kind of support.

Mr. Chairman, I would like to ask unanimous consent to enter the NADB bank's 2014 annual report and Moody's 2015 rating of the NADB bank into the record for today's hearing.

Chairman HUIZENGA. Without objection, it is so ordered. And you actually beat me to the punch.

Mr. HINOJOSA. With that, I yield back.

Chairman HUIZENGA. The gentleman yields back. I was going to request the same to point out the charts that NADB bank itself had submitted for 2013 and 2014. As far as their total dollar infrastructure spent, 36.6 percent in wind energy and 26.5 percent in solar energy in 2013; and 36.3 percent in wind energy and 28.8 percent in solar energy in 2014.

Those were their own numbers, which we are comparing apples and oranges when 26 of those projects accounted for two-thirds of the total funding that they utilized.

So without objection, the NADB bank 2014 annual report will be submitted.

And I would like to thank our witness today for his testimony, the Honorable Dr. Nathan Sheets.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place his responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is adjourned.

[Whereupon, at 11:45 a.m., the hearing was adjourned.]

# A P P E N D I X

April 27, 2016

**EMBARGOED FOR DELIVERY**

**Nathan Sheets**
**Under Secretary for International Affairs, United States Department of the Treasury**
**Testimony before the House Committee on Financial Services**
**Subcommittee on Monetary Policy and Trade**
**"How Can the U.S. Make Development Banks More Accountable?"**
**April 27, 2016**

Chairman Huizenga, Ranking Member Moore, and Members of the Committee, thank you for the invitation to testify today. I appreciate the opportunity to discuss Treasury's engagement with and oversight of the multilateral development banks (MDBs).

Through our leadership in the World Bank, the regional development banks, and the International Monetary Fund (IMF), the United States has an effective means to influence global economic events, promote American values, support our allies, and help drive inclusive growth and poverty reduction both at home and around the world.

The MDBs – the World Bank, African Development Bank (AfDB), Asian Development Bank (AsDB), European Bank for Reconstruction and Development (EBRD), Inter-American Development Bank (IADB), and North American Development Bank (NADB) – are vital and cost-effective partners for the United States. These institutions, together with the IMF, promote international economic cooperation, which has shaped the postwar economic and financial architecture and helped support global growth.

**The Role of Multilateral Development Banks**

The MDBs are designed to serve a broad range of developing countries across many sectors. The MDBs aim to support development through investments that are not possible with private capital and domestic resources alone, and also provide services geared toward building capacity and expertise in developing countries. These services include technical assistance, research, and data.

Developing countries look to the World Bank for financing for global public goods, including in areas such as health and the environment, among others, and provision of knowledge and data on global issues.

The regional development banks complement the World Bank's global reach through their expertise in areas of high importance to their region, a role that developing countries strongly value. For instance, the AfDB has a strong focus on infrastructure, regional integration, and agriculture and food security. The AsDB has strong expertise on infrastructure, regional market development, and natural disaster risk reduction. The IADB has focused on increasing citizen security and small and medium enterprise development in Latin America. The EBRD has a unique mandate to foster countries' transition to a market economy and democracy, and has expertise in private sector development in transition economies.

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Notably, the NADB plays a role that no other MDB can through its mandate to finance environmental infrastructure on both sides of the U.S.-Mexico border. The NADB is the only MDB that can provide financing to communities that are among the poorest in the United States and is an important component of the bilateral economic relationship with Mexico. The NADB's financing of projects in areas like wastewater collection and treatment, solid waste management, and air quality improvement enhance quality of life and protect the environment in communities on both sides of the border.

The MDBs' structures allow them to provide financing to the public and private sectors and support both low- and middle-income countries. The MDBs provide grants or highly concessional loans to low-income countries. This support is provided through the World Bank's International Development Association (IDA), the African Development Fund (AfDF), the Asian Development Fund (AsDF), and the IADB's Fund for Special Operations (FSO). These funds rely on periodic replenishments from donors, along with internally generated resources, to finance those grants and concessional loans.

The MDBs use their strong credit ratings to borrow from international capital markets. They then lend to middle-income countries at their borrowing costs plus a small spread. This allows middle-income countries to invest in development priorities, such as health, education, infrastructure, and environmental protection. Even those middle-income countries with access to international capital markets may not be able to borrow at rates low enough or attract sufficient private investment to invest in development priorities without jeopardizing their debt sustainability. MDB financing is thus a key component of their overall development financing.

MDBs' efforts to respond to the growing needs of the global economy, as well as provision of non-income generating services like technical assistance and research, mean that the MDBs occasionally require additional capital from shareholders. This capital ensures that they are able to maintain their strong credit ratings and continue providing development finance at reasonable costs.

The MDBs recognize that the private sector is central to sustainable development. Yet, the private sector continues to view many developing countries and sectors as too financially or politically risky to invest in. In addition to working with countries to create a more enabling business climate, the MDBs also provide loans, equity investments, lines of credit, and risk mitigation products to the private sector to catalyze private investments in developing countries and enhance the development outcomes of those investments. The World Bank and IADB have specialized arms, the International Finance Corporation and Inter-American Investment Corporation, respectively, that invest in the private sector at market-linked rates, while the other MDBs do this through their main window.

The MDBs and the IMF play complementary roles in fostering strong, sustainable, and balanced global growth. The IMF focuses on preserving the stability of the international monetary and financial system, including through financing for short-term macroeconomic stabilization. The MDBs support long-term development. For example, the MDBs finance infrastructure and encourage reforms to facilitate trade and investment and improve fiscal sustainability, which helps developing countries transform and diversify their economies. This assistance helps

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reduce the likelihood of macroeconomic crises and countries' potential need for IMF financing. The MDBs play a countercyclical role in countries that are experiencing severe macroeconomic shocks, but that role must be closely coordinated with the IMF.

The MDBs are a powerful tool for investing in countries and sectors for which other sources of financing are not available. These investments are critical for sustainable and balanced long-term economic growth in the United States and globally and for poverty reduction.

**Benefits of Multilateral Development Banks**

The MDBs are important contributors to U.S. national security and play an important role in assisting some of our key strategic partners, such as Afghanistan, Iraq, Ukraine, and Mali. The MDBs are helping to address the root causes and effects of state fragility and conflict, including how to meet the long-term needs of forcibly displaced persons, combat gender-based violence, and create job opportunities.

The MDBs are also supporting countries in undertaking reforms to strengthen governance, build transparent and accountable institutions, improve public administration, mobilize domestic resources, and increase citizens' access to information. The United States is urging the MDBs to provide increased technical assistance in areas such as anti-money laundering and countering the financing of terrorism to help reduce illicit finance flows, including to extremists. The MDBs play a critical role in helping countries deliver improved social services, build infrastructure, and reform the business climate, which not only strengthens the bond between states and their citizens, but also creates jobs that are needed to help reduce the lure of extremism.

The MDBs similarly contribute to U.S. and global economic prosperity. The MDBs identify and design commercially viable projects in which U.S. companies can effectively compete and are among the largest official financiers of infrastructure, especially cross-border infrastructure, in Africa, Asia, Latin America, and Eastern Europe. These investments expand markets and complement initiatives to increase U.S. exports.

The MDBs are making significant investments in energy access for households and businesses, and are especially contributing to the development of markets for renewable technology. Combined with support for energy sector reforms, including for energy efficiency and promotion of greater cross-border energy linkages, the MDBs are expanding access to cheaper and more reliable electricity needed for growth.

Job creation is also at the heart of MDB activities, ranging from the financing of small entrepreneurs to regulatory reforms that open up private sector opportunities across the globe. Close to home, the NADB's investments in environmental infrastructure on both sides of the U.S.-Mexico border expand much needed municipal services and reduce the costs of doing business in the region, which supports job growth and builds more prosperous communities.

Last year, the international community made a series of new commitments, signaling a shift toward using official development finance to catalyze private sector investment and mobilize domestic resources. The MDBs are bolstering investment, growth, and private-sector job creation

by connecting private investors with opportunities in developing countries. The United States has also encouraged the MDBs to develop additional financial tools that can promote increased private investment in lower-income countries.

**Modernization of Multilateral Development Banks**

The MDBs deliver strong strategic, economic, and development returns for the United States, but they must evolve to meet ever-changing global challenges and strengthen necessary accountability. To achieve these objectives, it is important that the MDBs continue to modernize their governance structures, review their use of existing financial resources, and bolster their efficiency and effectiveness.

As the largest or co-largest shareholder in each of the MDBs, except for the AfDB, the United States is well-positioned to encourage the MDBs to reform their governance structures to reflect the changing realities of the global economy and incentivize donor contributions to support the MDBs' work in the poorest countries. As emerging markets seek greater influence in the MDBs, the United States is asking these countries to assume greater responsibilities, including gradually moving away from MDB borrowing and increasing their role as donors.

The MDBs offer the United States significant financial leverage – the $1.8 billion request for the MDBs in the President's FY 2017 Budget would support more than $100 billion in MDB investments in developing countries. In response to calls from the G-20, the MDBs are taking steps to make their existing resources go even further. In particular, they are exploring options to more efficiently deploy their balance sheets, which can boost lending capacity for both low- and middle-income countries, improve capital adequacy, and potentially decrease reliance on donor contributions. The AsDB has already done so and the IADB is exploring such options as well. The NADB has effectively catalyzed more private investment as a portion of projects it invests in. This will further ensure the efficient use of the capital that the NADB receives through its ongoing general capital increase. The United States will continue to press the MDBs to innovate further in the efficient use of resources.

Even as the MDBs maximize their existing resources, they will continue to need strong financial support from the United States and other shareholders. In particular, the MDBs' ability to support the poorest countries will require continued donor contributions. Treasury is working with the Administration in hopes of placing those contributions on a declining trajectory over the longer term as countries continue to develop. However, robust support will still be needed for the IDA, AfDF, and AsDF replenishments that donors, including the United States, intend to make pledges to in 2016.

The United States has encouraged the MDBs to undertake regular and disciplined reviews of their capital needs, including projections for capital adequacy metrics and analysis of how capital can be used as effectively as possible. Last year, shareholders unanimously decided to conduct a review of the World Bank's capital situation in 2017.

As a complement to their efforts to boost their financial efficiency, the MDBs must also take steps to improve the efficiency of their operations. These steps include streamlining processes

**EMBARGOED FOR DELIVERY**

for approving projects, strengthening country procurement practices to speed disbursements, and increasing attention to project preparation. The United States is encouraging the MDBs to respond to shareholders' criticisms that project review and implementation is too slow. This response must not compromise high social, environmental, and fiduciary standards.

The United States – with the strong support and encouragement of Congress – has long been at the forefront of securing improvements in accountability and transparency at these institutions. Not only has the United States led the charge at the World Bank to help secure a new Environmental and Social Framework that will significantly strengthen safeguards, but we have championed the adoption of environmental and social safeguards at all the MDBs. The United States successfully pressed for the establishment of policies on access to information. Additionally, the United States insisted on the creation of independent oversight bodies to investigate allegations of corruption in MDB projects and provide a forum to which people harmed by MDB projects can bring their complaints.

Finally, the MDBs must measure success by the outcomes of projects, rather than by the amount of financing provided. The United States continues to encourage the MDBs to adopt even stronger evaluation policies for both accountability and to fully incorporate lessons learned into their future activities.

For the past 70 years, U.S. leadership has ensured that the MDBs have remained critical partners in supporting U.S. strategic and economic priorities. It is crucial that the United States and the MDBs, working together, continue to deliver on those priorities, including supporting peace, security, and sustainable economic growth.

Thank you and I welcome your questions.

*QFRs for Under Secretary Nathan Sheets*
*House Committee on Financial Services*
*"How Can the U.S. Make Development Banks More Accountable?"*
*Hearing Held April 27, 2016*

**Rep. Denny Heck (WA-10)**

**Question 1:**

**I recently read a World Bank report[1] which said that the Asia-Pacific region accounted for two-fifths of global growth in 2015—more than twice the contribution of all other developing regions combined. Because of this outsize importance, and because Asia is the primary destination for goods shipping from Western Washington ports like Tacoma, Olympia, and Seattle, I am particularly interested in development in this part of the world.**

**In recent years, significant resources have been marshaled to address the urgent infrastructure needs in the Asia-Pacific region. The Asian Development Bank agreed a capital increase in 2009, and recently merged its two lending windows to increase its overall lending ability. We have also seen the emergence of a new institution, the Asian Infrastructure Investment Bank, and increases in assistance provided by individual countries in the area, such as Japan and China.**

- **Given all of this recent activity, what is your assessment of the current gap between infrastructure needs and available resources in the Asia-Pacific region?**
- **What do you see as the biggest impediment to closing this gap?**

Answer:

The Asian Development Bank has estimated the infrastructure financing gap in Asia to be around $200 billion per year, based on projections of investment needed to maintain current economic growth and the resources available from public, private, and multilateral sources. New sources of official development assistance can help bridge that gap, but the sums needed are simply too large to rely on official sources of finance alone. Developing countries need to attract private investment in infrastructure as well.

The biggest impediment we see to closing the gap is the lack of sound enabling environments for private investment. To address this challenge, these countries require technical assistance and policy reforms to strengthen their local investment climates, remove inappropriate legal and regulatory burdens, broaden and deepen local financial markets, and develop a pipeline of well-designed, bankable projects.

**Question 2:**

**In the latest Semiannual Report on International Economic and Exchange Rate Policies, Treasury used new criteria outlined in the recently-passed customs bill. Page 2 of the report notes that in determining how to apply these criteria, "Treasury took a thorough approach, analyzing data spanning 15 years across dozens of economies."**

[1] World Bank "East Asia Pacific Economic Update, April 2016: Growing Challenges"

- **Apart from the criteria you developed to evaluate currency policy going forward, are there particular trends that stood out to Treasury as you were reviewing the historical data?**
- **The report found that no countries are currently distorting their currencies' value under the criteria used in the report. Were there periods in the past where countries were pursuing policies that would have been considered distortionary under the new criteria, and what was their effect on the U.S. economy?**
- **Looking at the issue over time, what lessons can we draw about what has been effective and what has not when trying to address currency distortions?**

Answer:

Consistent with the "Customs Bill", Treasury has set thresholds for the three criteria in the legislation that will help Treasury assess the economic and foreign exchange policies of the major trading partners of the United States. Historical data show that the ordering of countries by the size of their bilateral surpluses in U.S. dollars is relatively stable over time, and that there is a rapid drop off from the largest few bilateral surpluses. The data also show that current account balances – whether surpluses or deficits – are slow to adjust, regardless of the exchange rate regime.

From a historical perspective, the thresholds would capture the periods of concern regarding the economic outcomes and policies of key trading partners. In particular, based on the thresholds set by Treasury in the Report, China and Korea would have been subject to 'enhanced analysis' at various times in the past decade.

The President has stated that it is inappropriate for any country to grow its exports through a persistently undervalued exchange rate. Such an approach would put American workers and businesses at a competitive disadvantage. Making sure that American workers and business compete on a level-playing field is a top priority for the Administration. We have advanced this priority through our engagement in the G-7, the G-20, and the International Monetary Fund, as well as bilaterally, including in particular with China through the Strategic & Economic Dialogue. Our goal is to move major economies to market-determined exchange systems with transparent and flexible exchange rates that reflect underlying economic fundamentals. Continued attention to this issue with our key partners is essential to maintain positive progress on exchange rate matters.

MAY 20, 2015

SOVEREIGN & SUPRANATIONAL

MOODY'S
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CREDIT ANALYSIS

Rate this Research

# North American Development Bank

Supranational

RATINGS

NADB

| | Rating | Outlook |
|---|---|---|
| Long-term Issuer | Aa1 | STA |
| Short-term Issuer | P-1 | STA |
| Senior Unsecured | Aa1 | STA |

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This Credit Analysis provides an in-depth discussion of credit rating for NADB and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website.

## Overview and Outlook

The North American Development Bank's (NADB) Aa1 ratings reflect the Bank's strong capitalization and liquidity position, as well as the high support it is expected to receive from its two sovereign members (the US and Mexico). These strengths are counterbalanced by risks that relate to (1) the narrow geographical mandate that contributes to the Bank's loan portfolio containing more concentration risk than its MDB peers, and (2) the rapid loan portfolio growth over the past few years, with an expanded focus on private sector lending.

As the Bank has been growing rapidly, its capital adequacy ratios have fallen steadily and significantly. The ratio of usable equity to gross loans outstanding fell from an extraordinary 434.9% in 2006 to 45.8% in 2014. Despite the decline, this level of capitalization remains strong relative to peers. While we expect it will continue to deteriorate over the medium-term, it should remain strong given the Bank's projections and its capital adequacy policies that effectively limit the amount of deterioration.

Meanwhile, the Bank's liquidity position remains high and contributes to mitigate risks to bondholders. We assess the Bank's liquidity policy as very strong, both in the number of months of coverage and the breadth of coverage of cash outflows. Furthermore, the Bank has historically over-complied with the policy.

In January 2015, the Board of Directors of NADB announced the support of both sovereign members for a general capital increase of $3 billion for the Bank, of which $450 million would come in the form of additional paid-in capital. Although pending congressional approval in both countries, the additional paid-in capital would help maintain the Bank's strong financial ratios.

An upward reassessment of the rating could arise from a significant and sustained improvement in the credit quality of the Bank's loan portfolio or a reduction in concentration risks of the portfolio.

As the NADB's loan portfolio continues to grow, with exposure predominantly to the private sector in contrast to its historical focus on municipalities and municipally-owned utilities that received significant credit enhancement from the Mexican Fideicomiso trust mechanism, a significant deterioration in asset quality and performance could prompt a rating downgrade.

This Credit Analysis elaborates on NADB's credit profile in terms of Capital Adequacy, Liquidity and Strength of Member Support, which are the three main analytic factors in Moody's Supranational Rating Methodology.

## Organizational Structure and Strategy

Headquartered in San Antonio, Texas, the Bank was established in 1994 under the *Agreement Between the Government of the United States of America and the Government of the United Mexican States Concerning the Establishment of a Border Environment Cooperation Commission and a North American Development Bank* as part of the NAFTA[1] negotiations between the governments of the two countries. The Bank's three main areas of operation are loans, grants, and technical assistance and training primarily to border municipalities and private sector companies in both Mexico and the US. The loan program is its primary function and aims to improve environmental quality by financing infrastructure projects. The Border Environment Cooperation Commission (BECC) evaluates the technical feasibility and environmental impact of projects to be financed by NADB.

The loan program is the focus of our credit analysis because it inherently exposes the largest portion of the Bank's assets to credit risk, which, as with any MDB, has the potential to impact the Bank's ability to service its debt if not properly mitigated. The Bank has one subsidiary of which it owns 99.90%, Corporacion Financiera de America del Norte (COFIDAN), which facilitates its lending to Mexican borrowers, primarily in the public sector. The Mexican government owns the remaining 0.10% of COFIDAN.

### Capital Structure

Mexico and the US equally subscribe NADB's total capital of $3 billion, with $450 million paid in and the remainder callable. Of the paid-in portion, 90% is used for the Bank's main loan program (environmental or international program) and 10% was transferred to the general reserve for its secondary loan program (domestic programs). Therefore, the effective paid-in capital that we use in our measures of capital adequacy is the $405 million portion for the international program. The callable portion of the capital can only be used to service the Bank's debt or to make similar payments on loans that it guarantees.[2] As such, the callable capital provides considerable protection to bondholders and is a factor in Moody's Aa1 rating; the amount pledged by the both members is included in measures of capital adequacy, discounted by the expected loss implied by their ratings.

In January 2015, the Board of Directors of NADB announced the support of the governments of the US and Mexico for a general capital increase of $3 billion for the Bank, of which $450 million would come in the form of additional paid-in capital. The capital increase would be apportioned during an estimated period of five years. We note that the capital increase still requires congressional approval in both countries. As such, in this report our forecasts for financial ratios continue to assume the current capital structure.

### Development Operations

NADB makes both loans and grants and provides technical assistance and training primarily to border municipalities and municipally owned utilities in Mexico and the US. The loans and grants are for infrastructure projects involving air quality, water supply, wastewater treatment, and storm water drainage. Additional areas where it provides assistance include solid waste management, clean/renewable energy, energy efficiency, and industrial/hazardous waste; it is also authorized to lend to private sector projects that provide environmental benefits, and this part of the lending portfolio has increased substantially in the past couple of years. Geographically, projects must be within 100 kilometers of the border in the US and within 300 kilometers of the border in Mexico, restricting the Bank to four US states (Arizona, California, New Mexico, and Texas) and six Mexican states (Baja California, Chihuahua, Coahuila, Nuevo Leon, Sonora, and Tamaulipas). There is no requirement as to the proportion of loans that must be extended in each country. The Bank's institutional lending policy restricts loans and guarantees to the amount of the Bank's subscribed capital, unimpaired reserves, and undistributed surplus.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

[1] North American Free Trade Agreement.

[2] The Bank has no guarantees outstanding as of the date of this report.

Credit Analysis Centers On International Loan Program

Funded with 10% of NADB's paid in capital, with that amount divided equally between Mexico and the US, the domestic programs were created to finance community adjustment and investment programs (CAIP) throughout the two countries in support of the purposes of NAFTA. The $22.5 million allocated to Mexican CAIP was transferred to the Mexican federal government in 1999, while the Bank administers USCAIP's $22.5 million on behalf of the US federal government. Therefore, USCAIP is reported along with NADB's International Program, but the two programs' operations are completely independent of each other; USCAIP's profits, losses, expenses, and disbursements have no impact on NADB's retained earnings nor is its net income available to support any of NADB's obligations. A Finance Committee appointed by the US federal government selects and endorses the loans that NADB finances with the allocated funds. Therefore, the ultimate bearer of the risks associated with USCAIP loans is the US federal government, not NADB.

As such, Moody's credit analysis of NADB focuses on its international program. In this report, including the data tables at the end and in any other Moody's publication about the Bank, all data is in reference to the consolidated accounts of NADB and COFIDAN only and does not include the operations of USCAIP.

## Rating Rationale

Our determination of a supranational's rating is based on three rating factors: Capital Adequacy, Liquidity and Strength of Member Support. For Multilateral Development Banks, the first two factors combine to form the assessment of Intrinsic Financial Strength, which provides a preliminary rating range. The Strength of Member Support can provide uplift to the preliminary rating range. For more information please see our Supranational Rating Methodology.

### Capital Adequacy: High

Despite deterioration in capital adequacy ratios due to rapid loan growth, coverage remains strong

**Factor 1**

| Scale | Very High | High | Medium | Low | Very Low |
|---|---|---|---|---|---|
| + | | ■ | | | - |

Capital adequacy assesses the solvency of an institution. The capital adequacy assessment considers the availability of capital to cover assets in light of their inherent credit risks, the degree to which the institution is leveraged and the risk that these assets could result in capital losses.

NADB's 'High' Capital Adequacy assessment balances a strong capital position, still low but rising leverage relative to peers and good asset quality with high concentration risk stemming from the Bank's mandate and the expectation that some of NADB's currently strong metrics will deteriorate as its loan portfolio grows over the coming years.

After Rapid Growth in 2012, Loan Portfolio Expansion Has Moderated

Despite its 20-year history, the Bank historically focused on its grant operations and therefore the loan portfolio was small, with loans outstanding averaging 21.4% of total assets during the 2003-08 period. Since that period the Bank has transitioned to become a veritable lender after significant and rapid loan growth; loans outstanding at end-2014 amounted to 73% of total assets.

Following one-off events that caused the loan book to shrink during 2011, the Bank's loan portfolio resumed its rapid pace of growth during 2012. In 2012 both the high number of new loans extended during the year

(10), as well as larger size of the new loans, drove the increase. The record loan growth during 2012 was a result of one-off events and has moderated since then. Fiscal incentives for US solar and wind companies were expected to expire in 2012, causing companies to seek financing for projects before expiration. The Bank's two largest loans ever ($110 million each) were extended in December 2012.

In 2014, the bank maintained a moderate pace of loan growth, with gross loans outstanding increasing by 17.2%. The Bank extended 9 new loans during 2014, six in the US and three in Mexico. The average size of new loans was more than 50% greater than in 2013. Going forward, based on the pipeline of committed loans planned for disbursement in 2015 and 2016 and projections thereafter, the Bank expects annual loan growth to average 10% during the 2015-2019 period.

The Bank's institutional lending policy restricts loans and guarantees to the Bank's subscribed capital, unimpaired reserves, and undistributed surplus. In practice, this threshold is unlikely to be reached due to the Bank's debt limit, which limits the outstanding debt stock to 100% of callable capital plus the minimum liquidity level set by the liquidity policy.

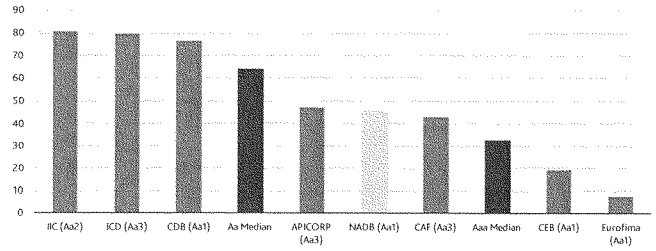
Strong Capital Position Supported by Ample Coverage of Risky Assets and Moderate Borrower Quality

As a result of the growing loan portfolio, NADB's capital adequacy ratio (usable equity as a percent of gross loans outstanding and equity operations)[7] has declined in recent years. This ratio fell from an average of 180% in 2007-11 to 46% in 2014. Nevertheless, NADB's coverage of its development-related assets continues to be strong among the MDBs rated by Moody's, although lower than the median for Aa-rated entities but higher than the 'Aaa' median (see Exhibit 1). We expect that over the coming years the coverage ratio will continue to decline but will remain high.

EXHIBIT 1

**Asset Coverage in Line with Aa-rated Peers**

Usable Equity/Gross Loans Outstanding + Equity Operations (%, 2014 or latest available)




*Note: Please refer to the Appendices for a list of MDB acronyms used in this report.*
*Source: Moody's*

In terms of the credit quality of the Bank's borrowers, this too has deteriorated slightly over the past few years given the greater focus in lending to the private sector. The share of loans to private enterprises has stabilized around 65% and is expected to rise to 72% in 2015, up from 60% in 2012. Moreover, borrower quality remains medium relative to other rated MDBs as a significant portion of the loan book is still allocated to US and Mexican state and local governments. US public entities' ratings tend to be higher on the global rating scale. Meanwhile, while rating coverage of Mexican municipalities is not as widespread, one

[7] Under our methodological approach, in our scorecard we also include discounted liquid assets in the denominator of this ratio.

credit enhancement is that in 65% of the loans extended in Mexico (and therefore 26% of total loans), there is a trust mechanism in which federal government transfers are allocated to be used for servicing COFIDAN loans.

In this mechanism, called a *fideicomiso*, the borrowing municipality instructs the Treasury to deposit a portion of its Federal Tax Revenues (*participaciones*) into a trust. The trust uses the funds (which typically exceed the total debt service requirement) exclusively to pay debt service obligations directly to COFIDAN.[4] This is a strong credit enhancement in that it establishes a near-direct link between NADB and the federal government so that the loans are likely to be stronger than what the credit ratings of the borrowing entities would otherwise indicate, and their credit quality is near the federal government's own A3 rating. The Bank has decided to require the use of such a mechanism for all new COFIDAN loans, which is supportive of asset quality.

Leverage Has Risen to Levels Similar to Peers

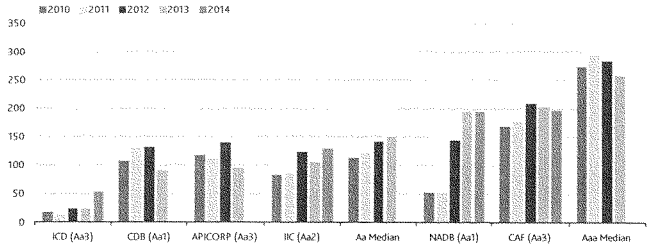
The Bank did not issue debt until 2010 after its lending activity had increased significantly. This was followed by the issuance of three bonds in 2012 and one bond in October of 2013, which brought the total stock of notes payable to $1,030 million as of December 2014.[5,6] Additionally, in November 2012 the Bank signed a loan commitment with another development Bank to borrow up to $50 million to fund eligible projects in Mexico. This loan will amortize semi-annually, with the first principal payment payable on December 30, 2015 and final principal payment payable on December 30, 2024. As of year-end 2014, NADB had borrowed $30 million under this facility.

In relation to the Bank's capital available to protect bondholders, debt in 2014 represented 195% of equity. This metric has also worsened as NADB expanded it lending operations in recent years but it is somewhat higher than, but still in line with, other Aa-rated MDBs (see Exhibit 2). Going forward, while we expect NADB to continue to issue debt, leverage will remain moderate and comparable to other MDBs in terms of capital coverage, with the debt-to-equity ratio likely in the 200-300% range over the next few years.

EXHIBIT 2

**Leverage Has Grown, Surpassing Most Aa Peers**

Debt/Usable Equity (%)




*Source: Moody's*

[4] For a more detailed description see Moody's Rating Methodology for Enhanced Municipal and State Loans in Mexico, June 2014

[5] Notes payable net of discount and fair value of hedges relating to interest rate notes equaled $1,031 million as of December 2014

[6] NADB issued a Swiss Franc 10-year bond for CHF325 million (€329 million) in April, 2015.

Ensuring that debt will not become oversized, during 2012 the board established a debt limit policy whereby the Bank's total outstanding debt stock is not to exceed total callable capital plus the minimum liquidity level required by the Bank's liquidity policy. Previously, debt was only limited in annual increments by the board's borrowing authorizations. While the annual authorizations will still take place, the new institutional debt limit is one example of management's awareness of the increasing risks that accompany larger operations and its efforts to increase governance and risk management in tandem with lending activity.

### Asset Quality Remains Strong

At end-2014 one loan was in nonaccrual status, representing just 0.3% of outstanding loans in the International Program. Non-performing loans (NPLs) have decreased from 4.8% (three loans) in 2011, after a loan charge-off the subsequent year. Likewise, reserve[7] coverage increased to 16.1x NPLs in 2014 from a low of 2.8x in 2011 (when including allowances for loan losses the coverage increases to 19.4x and 3.2x for 2014 and 2011, respectively). Reserve coverage strengthened after the Bank implemented a new general allowance practice. Previously it only made special allowances for troubled loans; the increased provisioning practice brings the Bank in line with most other MDBs.

Although the Bank has a track record of a low number of problem loans, we think that as the loan portfolio continues to grow, NPLs will likely rise, particularly as the loan portfolio becomes more concentrated in the private sector. Nevertheless, we do not expect this to materially impact the Bank's overall capital adequacy.

### Concentration Risk Stems From Binational Mandate

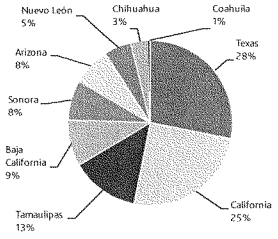
Resulting from their mandate, regional MDBs face a high degree of geographical concentration risk in their loan portfolios. Relative to all other Moody's-rated MDBs, NADB faces the highest degree of this risk in that it only operates in two countries with an additional forced concentration to within a 400km North-South band. Despite the Bank lending in nine of the 10 states its mandate allows, the Bank's portfolio is concentrated by country and by state. At end-2014, 61% of the outstanding International Program loans were extended in the US. The top three states in which it lends, Texas, California and Tamaulipas, account for 66.5% of the portfolio, down from 73.4% a year ago (see Exhibit 3). In addition, loan count is higher in Mexico, but the larger loan sizes to the renewable energy sector in the US also lead to borrower concentration within the portfolio (see Exhibit 4). While lending in terms of sectors may at first appear concentrated, we consider that risks are lessened by the fact that there is a relatively low correlation between the performances of the sub-sectors.

[7] Reserves are Undesignated Retained Earnings plus Special Reserve (a component of Reserved Retained Earnings).

EXHIBIT 3

**Portfolio Distribution By State**

(% of loans outstanding, 2014)

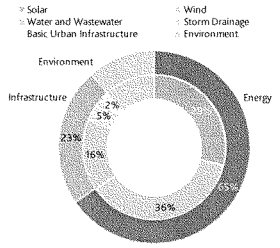



*Source: NADB*

EXHIBIT 4

**Portfolio Distribution By Sector and Segment**

(% of loans outstanding, 2014)




*Source: NADB*

Going forward the Bank's adjustments in 2013 to the single obligor limit should alleviate some of the concentration. Although the adjustments increased the percentage from 15% to 20%, they also significantly reduced the absolute level by reducing the base on which it is calculated.[8] The Bank has made progress reducing its exposures to very large borrowers, with the top ten loans representing 53% of the total in 2014, down from about 70% in 2012. As the loan book continues to grow, this exposure to single obligors will likely continue to moderate.

## Liquidity: High

Favorable debt structure leads to current high liquidity position

**Factor 2**

| Scale | Very High | High | Medium | Low | Very Low |
|---|---|---|---|---|---|
| + | | | | | - |

A financial institution's liquidity is important in determining its shock absorption capacity. We evaluate the extent to which liquid assets cover debt service requirements and the stability of the institution's access to funding.

The 'High' score for Liquidity for NADB considers the Bank's very strong liquidity position and its proven market access during periods financial market turmoil despite its relatively young bond issuance program.

### Liquidity Remains Ample as Debt Servicing Will not Commence Until 2018

The Bank started issuing bonds in 2010. Given that all bonds are bullet and the first one will mature in 2018 (see Exhibit 5), NADB's Debt Service Coverage ratio[9] is among the strongest in the MDB universe at 0%. While the loan commitment signed by NADB with another development bank to borrow up to $50 million will begin amortizing in late 2015, our medium-term expectation is that the Debt Service Coverage ratio will continue to score Very High.

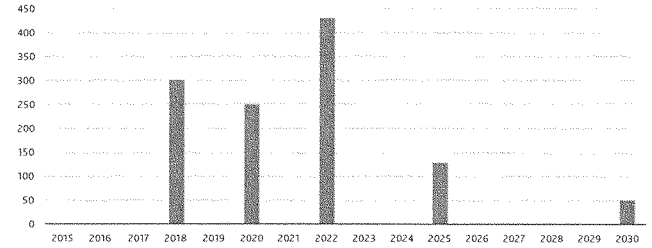
[8] The single obligor limit is set at 20% of the NADB's usable equity defined as the bank's funded, unimpaired paid-in capital, plus undesignated retained earnings, plus special reserve, plus capital preservation reserve

[9] Short-term debt and currently-maturing long-term debt over discounted liquid assets.

EXHIBIT 5

**NADB Bond Repayment Schedule**

(US$ million)




*Source: NADB*

NADB's liquidity policy states that "the minimum amount of aggregate liquid asset holdings is equal to the highest consecutive 12 months of the following 18 months of expected debt service obligations, plus committed net loan disbursements (if positive), plus projected operating expenses for the relevant fiscal year." The Bank determines a minimum amount prior to the beginning of the fiscal year and can revise it during the year to account for major changes in outlook.

We assess the policy as very strong, both the number of months of coverage and the breadth of coverage of cash outflows. The policy effectively means the Debt Service Coverage ratio should never go above 100% meaning the Bank should always score at least "High" for this indicator. Supporting this expectation is the Bank's historic overcompliance with its liquidity policy. For the 2015 fiscal year, the minimum requirement under the liquidity policy is $148 million and actual liquid asset holdings were $443 million as of December 31, 2014, well in excess. In addition, the Bank's investment policy for treasury assets is conservative, with the discounting that we apply to the denominator of the Debt Service Coverage ratio not resulting in significant reduction.

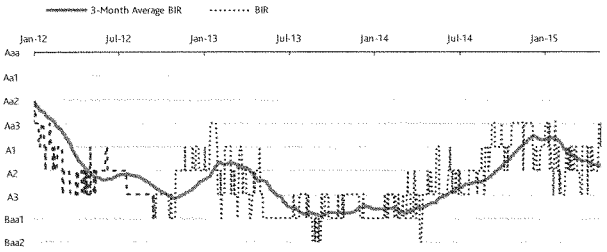
Another factor supporting the long-term strength of the Bank's strong liquidity position is that one of its reserve funds is a debt service reserve fund. It falls first in the order of priority for funding of any of the Bank's reserve funds and is maintained in an amount equal to 12 months of interest due on the Bank's outstanding debt at each fiscal year-end. This complements the liquidity policy and is a positive development in that it provides additional protection to bondholders above and beyond the liquidity policy.

### Funding Program is Still Relatively Young but Has Passed Stress Scenarios

Given that NADB only has five bonds outstanding, the Bank's small and infrequent issuance program results in low liquidity of its bonds in the secondary market. Nevertheless, NADB's bond-implied rating rose in 2014 relative to 2013, coming in on average at an A2 level from A3, and peaking recently at Aa3 (see Exhibit 6).

EXHIBIT 6

**NADB Bond Implied Rating Has Increased, Pointing to Stronger Market Access**




*Source: Moody's*

This also suggests that while the Bank's very young track record of issuance could lead to lack of market presence and therefore greater susceptible to market disruption, NADB has been able to issue debt at relatively favorable terms (weighted average original maturity of 9 years and average coupon rate is 2.89%) during episodes of financial market stress.

Its first bond issue in February 2010 was in the midst of the European sovereign debt crisis. The second issue in October 2012 was re-opened in December 2012 for a private placement. The placement carried the Bank's longest tenor at 18 years and a relatively low coupon. The Bank's most recent US dollar issue on October 10, 2013 was priced against a backdrop of the US government shut down/debt limit standoff – a very relevant development given the Bank's 50% ownership by the US. Despite the US instability, the bond was 2.3x oversubscribed, and even after the Bank decided to capitalize on the investor appetite and re-price the bond 12 bps, demand remained very strong. This favorable outcome despite significant turbulence of a sizeable shareholder is notable as investors commonly associate MDBs with their largest shareholders.

In April 2015, NADB issued its first non-USD bond by tapping the Swiss Franc market with a 10-year CHF125 million ($129 million) bond with a coupon of 0.25%. The bond was five times oversubscribed and NADB was able to attract a large number of institutional investors, pointing to increased market interest for NADB's paper. Although we expect that future issuances by NADB will likely take place in the US as the Bank seeks to maintain its positioning in the USD bond market, greater international interest will likely translate to improved borrowing conditions for NADB, particularly as its leverage is expected to increase over the coming years.

## Strength of Member Support: High

Strong member support limited by concentration risks

**Factor 3**

| Scale | Very High | High | Medium | Low | Very Low |
|---|---|---|---|---|---|
| + | | | | | - |

Contractual support primarily manifests itself in the callable capital pledge, which is a form of emergency support. Extraordinary support is a function of shareholders' ability and willingness to support the institution in ways other than callable capital. Strength of member support can increase the preliminary rating range determined by combining factors 1 and 2 by as many as three scores.

The NADB's 'High' score for Strength of Member Support reflects its shareholders' commitment to the institution as well as their ample ability to provide support in a stress scenario. These strengths are, however, counteracted by a highly concentrated and interlinked shareholder base.

### Callable Capital Continues to Provide Sizable Protection to Bondholders

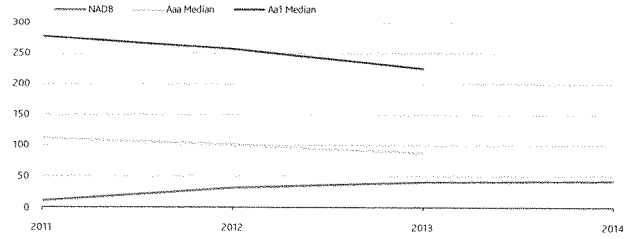
The Bank continues to benefit from substantial callable capital, which forms the basis of our member support assessment. Under our MDB methodology, our assessment takes into consideration the pledges of both investment grade members discounted for the expected loss rate that corresponds to their ratings. The evolution of our analytical approach has, thus, resulted in explicit incorporation of the commitments of the Mexican government into callable capital calculations.

Despite a considerable uptick in debt levels in recent years, the size of the callable capital cushion remains more than sufficient to largely mitigate credit risks for bondholders (see Exhibit 7). Assuming that the shareholders do not amend or rescind their capital pledges in an adverse scenario, callable capital commitments offer sufficient absorption capacity to insulate bondholders from any possible credit losses even if the debt burden were to double from its current levels.

EXHIBIT 7

**Debt Level Remains Moderate Relative to Callable Capital**

(debt-to-discounted callable capital, %)




*Source: Moody's*

### Members Display Strong Ability and Willingness to Support the Bank

The composition of the Board of Directors, which includes secretary-level officials from both federal governments, including the Treasury secretaries, coupled with the organization's visible progress in fulfilling its mandate, suggest strong willingness to support the institution as do the presence of strictly domestic programs and the high visibility conveyed by the unique bilateral nature of the organization.

In addition, the announced intention of the two government members to provide a general capital increase, although it is still pending congressional approval, supports our view that NADB is very likely to receive extraordinary support in case this was needed.

Also underpinning our member support score are the credit strengths of NADB's shareholders. While the US continues to exhibit stable credit dynamics, Mexico's sovereign rating has experienced upward pressure and was upgraded to A3 in February 2014 to reflect the expected positive impact of ongoing structural reforms,. With a median rating of A1, the Bank boasts the strongest shareholder base out of all regional MDBs in the Americas and compares favorably to the majority of regional MDBs outside of Europe. Additionally, in view of the institution's very small size relative to the combined federal budgets of the two member countries, the costs of a recapitalization in an adverse scenario would likely prove negligible. It therefore appears highly unlikely that the question of supporting the Bank would become politically contentious even in a context of severe economic distress.

Notwithstanding the abovementioned strengths, we also note that the US is an anchor shareholder of numerous other MDBs, including the IBRD, IFC, ADB and EBRD. Given the high visibility of those institutions and the reputational costs associated with their failure, we do not believe with certainty that the US would prioritize NADB over its other commitments in a systemic crisis.

### Binational Mandate Leads to Member Concentration Risks

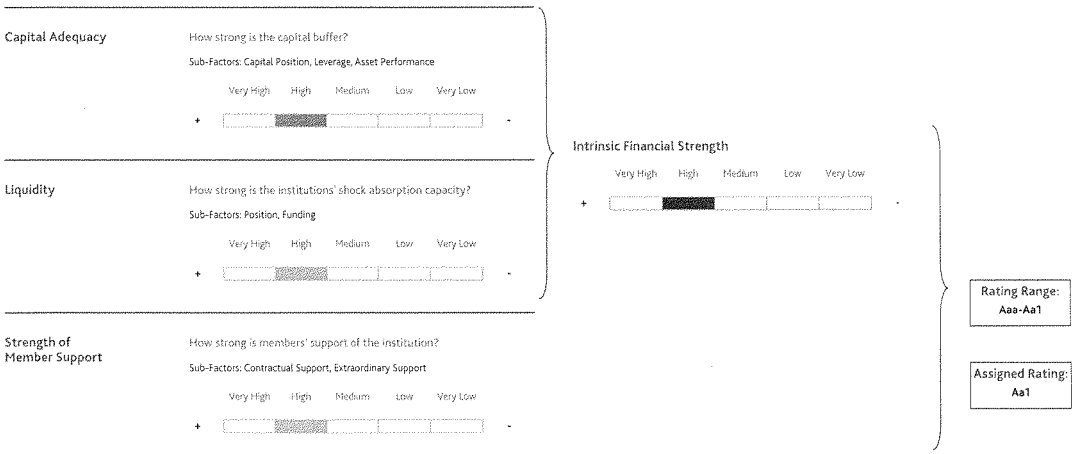
Constituting another weakness from the member support perspective, the organization's shareholder base is inherently highly concentrated. Equally split between its two members, the NADB ownership structure is the least diversified of all Moody's-rated MDBs. The issue of high member concentration is further exacerbated by the close economic linkages between the two countries. The US accounts for close to 80% of Mexico's total exports and the stock of US FDI in Mexico has recently exceeded $100 billion, solidifying its position as the largest foreign investor in the country. Given this strength of economic linkages, it is a virtual certainty that any episode of widespread economic distress in the US would be immediately followed by economic woes in Mexico, thus diminishing the benefits of shareholder diversification enjoyed by some other MDBs.

Furthermore, the NADB's lending operations in Mexico are primarily exposed to municipalities or municipally-owned utilities. With 65% of those loans benefiting from federal revenue transfers via a *fideicomiso* trust mechanism, the creditworthiness of those borrowers is closely linked to the financial health of the federal government. The resulting correlation between assets and members is, however, counterbalanced by the fact that those loans represent only 26% of the total gross outstanding loan portfolio, while loans to private sector borrowers in the US account for the bulk of the remainder.

## Rating Range

Combining the scores for individual factors provides an indicative rating range. While the information used to determine the grid mapping is mainly historical, our ratings incorporate expectations around future metrics and risk developments that may differ from the ones implied by the rating range. Thus, the rating process is deliberative and not mechanical, meaning that it depends on peer comparisons and should leave room for exceptional risk factors to be taken into account that may result in an assigned rating outside the indicative rating range. For more information please see our Supranational Rating Methodology.

Supranational Rating Metrics: North American Development Bank



## Comparatives

This section compares credit relevant information regarding NADB with other supranationals rated by Moody's Investors Service. It focuses on a comparison with supranationals within the same rating range and shows selected credit metrics and factor scores.

Although similar to that of the organization's closest peers, the NADB's size nonetheless falls on the lower end of the spectrum of all Aa-rated supranationals, contributing to the institution's concentration risks. Meanwhile, relatively high leverage constrain NADB's capital adequacy score. At 'High', the organization's capital adequacy assessment is relatively weak compared to its immediate peers but is in line with other Aa-rated institutions. The same is the case for the NADB's liquidity score, which balances the Bank's negligible refinancing needs against its somewhat less established market access. Combined, the two scores map to a 'High' intrinsic financial strength score, in line with other Aa-rated multilaterals. Finally, access to sizable callable resources and presence of highly-rated shareholders are reflected in the Bank's 'High' strength of member support assessment, which compares favorably to most peers and compensates for some of the relative weaknesses discussed above.

EXHIBIT 8

**North American Development Bank Key Peers**

| | Year | NADB | CDB[5] | IIC | NIB[5] | CEB[5] | ICD | Aa Median[5] |
|---|---|---|---|---|---|---|---|---|
| Rating/Outlook | | Aa1/STA | Aa1/STA | Aa2/POS | Aaa/STA | Aa1/STA | Aa3/STA | -- |
| Total Assets (US$ million) | 2014 | 1,633 | 1,452 | 1,989 | 32,395 | 33,767 | 1,522 | 6,037 |
| **Factor 1** | | High | Very High | Very High | Very High | High | Medium | -- |
| Usable Equity/Gross Loans Outstanding + Equity Operations (%)[1] | 2014 | 45.8 | 76.4 | 80.3 | 19.3 | 19.3 | 79.4 | 51.7 |
| Debt/Usable Equity (%)[1] | 2014 | 194.9 | 90.8 | 130.1 | 663.9 | 813.3 | 52.5 | 93.2 |
| Gross NPLs/Gross Loans Outstanding (%)[2] | 2014 | 0.3 | 0.5 | 2.0 | 0.0 | 0.0 | 20.5 | 0.0 |
| **Factor 2** | | High | High | Very High | Very High | Very High | High | -- |
| ST Debt + CMLTD/Liquid Assets (%)[3] | 2014 | 0.6 | 44.1 | 55.5 | 67.0 | 49.3 | 151.9 | 44.2 |
| Bond-Implied Ratings (Average) | 2014 | A2 | Baa1 | -- | Aaa | Aa1 | -- | Aa3 |
| **Intrinsic Financial Strength (F1+F2)** | | High | Very High | Very High | Very High | High | High | -- |
| **Factor 3** | | High | Very High | Medium | Medium | Medium | Medium | -- |
| Total Debt/Discounted Callable Capital (%)[4] | 2014 | 42.7 | 87.1 | -- | 329.7 | 488.6 | -- | 87.1 |
| Weighted Median Shareholder Rating (Year-End) | 2014 | A1 | Baa1 | A3 | Aaa | Aa3 | Aa3 | Aa3 |
| **Rating Range (F1+F2+F3)** | | Aaa-Aa2 | Aaa-Aa2 | Aaa-Aa2 | Aaa-Aa2 | Aa1-Aa3 | Aa1-Aa3 | -- |

Notes:

[1] Usable equity is total shareholder's equity and excludes callable capital

[2] Non performing loans

[3] Short-term debt and currently-maturing long-term debt

[4] Callable capital pledge by members rated Baa3 or higher, discounted by Moody's 30-year expected loss rates associated with ratings.

[5] Values refer to financial year 2013

*Source: Moody's*

## Appendices

### Rating History

**North American Development Bank**

| | Issuer Rating | | Senior Unsecured | Outlook | |
|---|---|---|---|---|---|
| | Long-term | Short-term | | | Date |
| Rating Lowered | Aa1 | P-1 | Aa1 | Stable | February-14 |
| Rating Under Review for Downgrade | Aaa | P-1 | Aaa | RUR- | December-13 |
| Rating Assigned | Aaa | P-1 | Aaa | Stable | January-10 |

### Moody's-Rated Multilateral Development Banks (MDBs) Referenced in the Report

| Acronym | Institution |
|---|---|
| APICORP | Arab Petroleum Investments Corporation |
| CAF | Corporación Andina de Fomento |
| CDB | Caribbean Development Bank |
| CEB | Council of Europe Development Bank |
| Eurofima | European Company for the Financing of Railroad Rolling Stock |
| ICD | Islamic Corporation for the Development of the Private Sector |
| IIC | Inter-American Investment Corporation |
| NADB | North American Development Bank |
| NIB | Nordic Investment Bank |

## Annual Statistics

EXHIBIT 9

**North American Development Bank**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|
| **Balance Sheet (US$ Thous)[1]** | | | | | | | | |
| **Assets** | | | | | | | | |
| Cash and Cash Equivalents | 53,077 | 64,176 | 34,283 | 38,403 | 36,778 | 62,357 | 56,810 | 85,086 |
| o/w Demand Deposit Accounts | 53 | 47 | 47 | 207 | 34 | 2,329 | 74 | 1,836 |
| o/w Interest Bearing Accounts | 48,925 | 51,529 | 31,136 | 35,296 | 33,843 | 48,528 | 39,336 | 52,349 |
| o/w Repurchase Agreements | 4,100 | 12,600 | 3,100 | 2,900 | 2,900 | 11,500 | 17,400 | 30,900 |
| Investment Securities | 184,631 | 193,343 | 135,912 | 236,040 | 313,791 | 326,217 | 488,713 | 357,868 |
| o/w Held to Maturity Investment Securities | 3,396 | 3,130 | 3,654 | 53,523 | 52,920 | 53,593 | 53,618 | 53,664 |
| o/w Available for Sale Investment Securities | 181,235 | 190,213 | 132,259 | 182,516 | 260,872 | 272,624 | 435,095 | 304,203 |
| Gross Loans Outstanding | 147,266 | 186,413 | 310,559 | 470,214 | 427,750 | 869,981 | 1,011,212 | 1,185,514 |
| Less Allowance for Loan Losses | 4,017 | 4,017 | 4,817 | 5,717 | 8,067 | 2,350 | 12,894 | 11,356 |
| Less Unamortized Loan Fees | 0 | 0 | 0 | 0 | 0 | 1,846 | 3,411 | 8,536 |
| Less FX Rate Adjustment and Fair Value of Hedged Items | -1,428 | 33,132 | 23,241 | 7,183 | 31,442 | 6,070 | 33,399 | 31,192 |
| Equals Net Loans Outstanding | 144,677 | 149,264 | 282,501 | 457,314 | 388,241 | 859,714 | 961,507 | 1,134,430 |
| Other | 3,930 | 58,883 | 37,919 | 22,642 | 81,208 | 54,017 | 66,045 | 55,985 |
| **Total Assets** | **386,315** | **465,666** | **490,616** | **754,399** | **820,018** | **1,302,304** | **1,573,075** | **1,633,369** |
| **Liabilities** | | | | | | | | |
| Notes Payable | 0 | 0 | 0 | 256,424 | 277,503 | 753,380 | 1,007,124 | 1,060,517 |
| Other Liabilities | 1,331 | 906 | 1,136 | 5,003 | 9,325 | 27,083 | 47,305 | 30,172 |
| **Total Liabilities** | **1,331** | **906** | **1,136** | **261,427** | **286,828** | **780,463** | **1,054,429** | **1,090,689** |
| **Equity** | | | | | | | | |
| Subscribed Capital | 3,000,000 | 3,000,000 | 3,000,000 | 3,000,000 | 3,000,000 | 3,000,000 | 3,000,000 | 3,000,000 |
| Less Callable Subscribed Capital | 2,550,000 | 2,550,000 | 2,550,000 | 2,550,000 | 2,550,000 | 2,550,000 | 2,550,000 | 2,550,000 |
| Equals Gross Paid-In-Capital | 450,000 | 450,000 | 450,000 | 450,000 | 450,000 | 450,000 | 450,000 | 450,000 |
| Less Transfer to General Reserve for Domestic Programs | 45,000 | 45,000 | 45,000 | 45,000 | 45,000 | 45,000 | 45,000 | 45,000 |
| Equals Paid-In-Capital | 405,000 | 405,000 | 405,000 | 405,000 | 405,000 | 405,000 | 405,000 | 405,000 |
| Less Scheduled Amount | 73,968 | 27,997 | 0 | 0 | 0 | 0 | 0 | 0 |
| Equals Funded Paid-In-Capital | 331,033 | 377,003 | 405,000 | 405,000 | 405,000 | 405,000 | 405,000 | 405,000 |
| General Reserve | 48,494 | 57,982 | 68,309 | 85,801 | 107,456 | 114,476 | 121,697 | 137,874 |
| o/w Designated Retained Earnings | 25,373 | 22,333 | 18,800 | 17,022 | 23,344 | 21,294 | 20,578 | 18,879 |
| o/w Undesignated Retained Earnings | 18,654 | 29,786 | 39,163 | 54,223 | 44,174 | 23,393 | 16,014 | 24,392 |
| o/w Reserved Retained Earnings | 4,467 | 5,863 | 10,346 | 14,555 | 39,938 | 69,789 | 85,106 | 94,603 |
| Accumulated Other Comprehensive Income | 5,457 | 29,775 | 16,171 | 2,171 | 20,734 | 2,365 | -8,050 | -194 |
| **Total Equity** | **384,984** | **464,760** | **489,480** | **492,972** | **533,190** | **521,841** | **518,647** | **542,680** |

EXHIBIT 9

**North American Development Bank**

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|
| **Income Statement (US$ Thous)[1]** | | | | | | | | |
| **Revenues** | | | | | | | | |
| Interest income | 16,641 | 18,197 | 19,709 | 26,398 | 26,421 | 24,321 | 39,543 | 43,710 |
| o/w Investment income | 11,400 | 9,836 | 8,325 | 5,886 | 5,428 | 4,977 | 4,394 | 5,224 |
| o/w Loan income | 5,241 | 8,361 | 11,384 | 20,512 | 20,994 | 19,344 | 35,149 | 38,487 |
| Gains on Sales of Available for Sale Investment Securities | 435 | 612 | 3,557 | 5,514 | 1,479 | 2,802 | -8 | 188 |
| Fee Income | 42 | 25 | 12 | 21 | 217 | 39 | 46 | 17 |
| Other | 0 | 790 | 590 | 508 | 9,204 | 550 | 0 | 1,038 |
| **Total Revenues** | **17,118** | **19,624** | **23,868** | **32,440** | **37,321** | **27,712** | **39,582** | **44,954** |
| **Expenses** | | | | | | | | |
| Total Operating Expenses | 7,167 | 6,415 | 7,844 | 8,733 | 10,397 | 11,407 | 20,377 | 13,153 |
| Provision for Loan Losses | 445 | 0 | 800 | 900 | 2,350 | 0 | 10,544 | 2,199 |
| Interest Expense | 0 | 0 | 0 | 4,095 | 4,532 | 5,363 | 10,838 | 13,548 |
| Litigation Expense | 0 | 0 | 0 | 0 | 0 | 1,484 | 0 | 0 |
| **Gross Expenses** | 7,167 | 6,415 | 7,844 | 12,828 | 14,929 | 18,255 | 31,215 | 26,700 |
| Program Income | 2,504 | 1,764 | 1,755 | 1,758 | 1,732 | 1,589 | 1,208 | 1,042 |
| Program Expense | 7,919 | 5,485 | 7,453 | 3,879 | 2,469 | 4,027 | 2,353 | 3,119 |
| **Net Program Expenses** | **5,415** | **3,721** | **5,698** | **2,121** | **737** | **2,437** | **1,145** | **2,077** |
| **Total Expenses** | **12,582** | **10,136** | **13,542** | **14,948** | **15,665** | **20,692** | **32,360** | **28,778** |
| **Income** | | | | | | | | |
| Net Income Attributable to Minority Interest | 0.2 | 0.2 | 0.1 | 0.1 | 0.2 | 0.2 | -0.2 | -0.4 |
| **Net Income/Loss** | **4,536** | **9,488** | **10,326** | **17,492** | **21,655** | **7,020** | **7,221** | **16,177** |

[1] All financial statements are for the consolidated accounts of NADB and COFIDAN only and exclude USCAIP.

[2] In 2006, NADB changed their fiscal year from ending on March 31 to ending on December 31. As such, the transition year, 2006 is a shorter reporting year than all other years and ranges from April 1, 2006 to December 31, 2006. Prior to 2006 the reporting years were April 1 to March 31. After 2006 the reporting years are January 1 to December 31. This is applicable to all financial statements and ratios in this report.

*Source: North American Development Bank*

EXHIBIT 10

North American Development Bank

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|---|---|---|
| **Financial Ratios** | | | | | | | | |
| **Capital Adequacy (%)** | | | | | | | | |
| Usable Equity/Gross Loans Outstanding + Equity Operations[1] | 261.4 | 249.3 | 157.6 | 104.8 | 124.6 | 60.0 | 51.3 | 45.8 |
| Debt/Usable Equity[1] | 0.0 | 0.0 | 0.0 | 52.0 | 52.0 | 144.4 | 194.2 | 194.9 |
| Gross NPLs/Gross Loans Outstanding[2] | 4.4 | 3.5 | 2.1 | 2.2 | 4.8 | 1.6 | 0.7 | 0.3 |
| Allowance for Loan Losses/Gross NPLs[2] | 61.6 | 61.6 | 73.9 | 56.0 | 39.5 | 17.0 | 184.9 | 335.4 |
| Return on Average Assets | 1.2 | 2.2 | 2.2 | 2.8 | 2.8 | 0.7 | 0.5 | 1.0 |
| Interest Coverage Ratio (x) | -- | -- | -- | 5.3 | 5.8 | 2.3 | 1.7 | 2.2 |
| **Liquidity (%)** | | | | | | | | |
| Liquid Assets/Total Assets | 61.5 | 55.3 | 34.7 | 36.4 | 42.8 | 29.8 | 34.7 | 27.1 |
| Liquid Assets/Total Debt | -- | -- | -- | 107.0 | 126.3 | 51.6 | 54.2 | 41.9 |
| ST Debt + CMLTD/Liquid Assets[3] | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Bond-Implied Ratings (Average) | -- | -- | -- | Aa2 | Aa3 | A2 | A3 | A2 |
| **Strength of Member Support (%)** | | | | | | | | |
| Total Debt/Discounted Callable Capital[4] | 0.0 | 0.0 | 0.0 | 10.4 | 11.3 | 30.7 | 40.9 | 42.7 |
| Weighted Median Shareholder Rating (Year-End) | A2 | A2 | A2 | A2 | A2 | A2 | A2 | A1 |

Notes:

[1] Usable equity is total shareholder's equity and excludes callable capital

[2] Non-performing loans

[3] Short-term debt and currently-maturing long-term debt

[4] Callable capital pledged by members rated Baa3 or higher, discounted by Moody's 30-year expected loss rates associated with ratings

*Source: Moody's*

## Moody's Related Research

Credit Opinions:

North American Development Bank

Mexico, Government of

United States of America, Government of

Announcement:

Moody's downgrades North American Development Bank to Aa1; outlook stable, February 2014

Rating Methodologies:

Multilateral Development Banks and Other Supranational Entities, December 2013 (161372)

Sovereign Bond Ratings, September 2013 (157547)

Moody's Website Links:

Sovereign Risk Group Webpage

Supranational Ratings List

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

## Related Websites

For additional information, please see:

» The North American Development Bank's website: http://www.nadbank.org/

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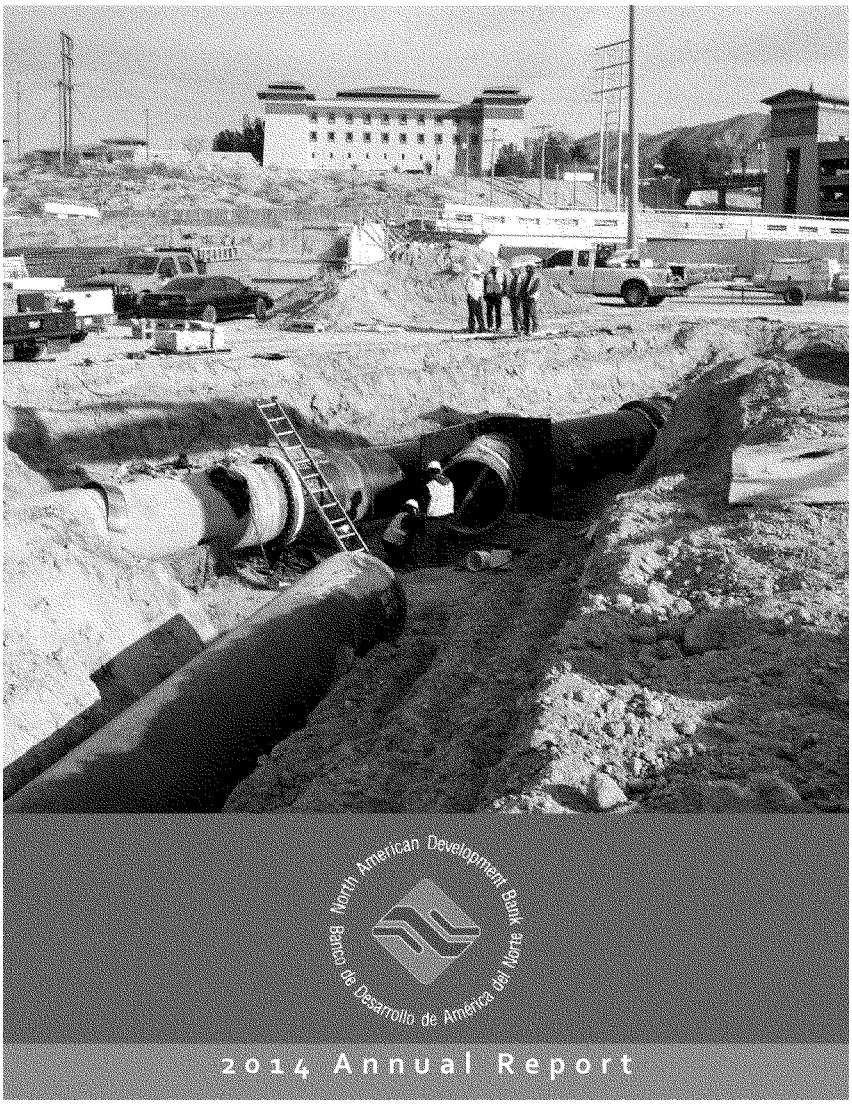

North American Development Bank
Banco de Desarrollo de América del Norte

2014 Annual Report

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# Message from Management

## April 2015

2014 was a momentous year for the **North American Development Bank (NADB)**, as steady growth in new loans and projects was complemented by a significant number of project completions, as well as important institutional decisions by its Board of Directors.

From an operational standpoint, 16 new projects were certified by NADB's sister institution, the Border Environment Cooperation Commission (BECC), and US$349.37 million in financing was approved, with the vast majority of this amount—US$323.67 million—in the form of loan financing. These projects will benefit an estimated 1.55 million residents through improved water and wastewater systems, clean and renewable energy and better air quality. As of December 31, 2014, NADB's loan portfolio had an outstanding balance of US$1.19 billion, representing an increase of 17.2% over the previous year.

In addition to these new projects, 20 previously certified projects reached construction completion, including 12 wastewater projects that together are collecting and treating more than 7 million gallons per day of sewage, and the installation of 114 megawatts of renewable energy capacity.

From an institutional standpoint, the BECC-NADB Board of Directors moved forward with two major initiatives. At the request of the Board, NADB management conducted an assessment of the Bank's long-term capital adequacy and its need for a general capital increase. The findings of this assessment, which were reported to the Board in December 2014, concluded that given NADB's current capital adequacy ratios, additional capital will be required to sustain its current rate of growth, address infrastructure needs and continue to fulfill its mandate.

In January, U.S. President Barack Obama and Mexican President Enrique Peña Nieto announced their support for doubling of the Bank's capital to US$6 billion. Authorization for the capital increase, along with appropriations for the first US$45 million tranche, are requested in President Obama's Fiscal Year 2016 Budget, which was presented to Congress on February 2 of this year. Mexico's Ministry of Finance and Public Credit (SHCP) is working to provide the first US$45 million installment in Mexico's 2016 fiscal budget as well.

Support for NADB's capital increase request—the first such request in the Bank's 20-year history—reflects the significant contributions this financial institution has made in helping the two countries meet shared bilateral goals in areas that both governments consider important—infrastructure, the border and the environment—and affirms their confidence in the continued success of NADB.

In another action reflecting the continued growth and development of the Bank, in December 2014, the Board of Directors approved a resolution recommending that the Governments of the United States and Mexico integrate BECC into a single entity with NADB. This recommendation for juridical and institutional integration of the two entities is the culmination of an initiative launched in July 2011 to streamline their project development processes and improve coordination of their respective activities, which will enhance their usefulness to border communities and make more efficient use of their available resources. Under the proposed integration, the mission, objectives and functions of the two institutions will be preserved, and their geographic jurisdiction and environmental mandate will remain unchanged. Project certification and financing will continue uninterrupted during the integration process, but with greater efficiency as their operations are fully merged.

NADB Management also maintained a focus on strategies to mitigate credit and operational risk as the Bank's loan portfolio continues to experience strong growth. The operational risk assessment that began in 2013 was completed in July 2014, and NADB management began implementation of key recommendations, including establishment of a centralized risk management area.

Moving forward, the Bank's management will continue working with relevant partners and stakeholders to assess infrastructure needs, develop projects for financing and implement programs for addressing these needs in order to help build a sustainable future for the U.S.-Mexico border region. In this regard, NADB's approach remains centered on conservative loan policies, diversification of project sectors in order to mitigate risk, and collaboration with other public, commercial and multinational financial institutions.

In closing, we want to extend our gratitude on behalf of the entire NADB team to all of our partners and stakeholders throughout the border region, in both the U.S. and Mexico, without whose collaboration and support we would not be able to accomplish our mission.

We proudly present the 2014 North American Development Bank Annual Report.

**Gerónimo Gutiérrez**
Managing Director

**Alex Hinojosa**
Deputy Managing Director

# General Overview

**Mandate and governance:** NADB is a binational financial institution established and capitalized by the governments of the United States and Mexico for the purpose of financing environmental infrastructure projects certified by its sister organization, the Border Environment Cooperation Commission (BECC), as well as offering technical and other assistance to support the development of eligible projects. The scope of the Bank's mandate—including the geographic jurisdiction and environmental sectors in which it may operate—as well as its functions and limitations, are defined in an agreement between the two governments (the "Charter").

As defined in the Charter, projects that qualify as environmental infrastructure are those that will prevent, control or reduce environmental pollutants, improve the drinking water supply, or protect flora and fauna, provided that such projects also improve human health, promote sustainable development, or contribute to a higher quality of life. A list of eligible environmental sectors and projects is shown in Box 1.

In addition, eligible projects must be located within 100 kilometers (about 62 miles) north of the international boundary in the four U.S. states of Texas, New Mexico, Arizona and California and within 300 kilometers (about 186 miles) south of the border in the six Mexican states of Tamaulipas, Nuevo Leon, Coahuila, Chihuahua, Sonora, and Baja California. However, projects beyond these areas may be deemed eligible if the Board determines that they remedy a transboundary environmental or health problem.

NADB and BECC are governed by a ten-member Board of Directors with equal representation from each member country (see Box 2). The chairmanship alternates between the United States and Mexico each year. All powers of NADB are vested in the Board of Directors, which determines policy within the framework of the Charter and approves all the Bank's programs and financing proposals involving NADB funds.

**Financing Operations:** The Bank provides loan and grant financing and technical assistance, as well as administers grant funding provided by other entities. Prior to financing approval, the technical feasibility and environmental impacts of the projects are evaluated and verified by BECC through a certification process that ensures transparency and promotes public participation. Project certification and financing proposals are approved simultaneously by the Board of Directors. Although project implementation is the responsibility of the project sponsors, NADB provides substantial project oversight and support during the procurement and construction phases of project execution to verify that the proceeds of its loans and grants are used efficiently and for purposes within the scope of the certified project.

## Box 1: Eligible Sectors

**Water:**
Potable water supply, wastewater treatment and reuse, water conservation, storm drainage

**Waste management:**
Sanitary landfills, collection & disposal equipment, dumpsite closure, recycling

**Industrial / hazardous waste:**
Treatment & disposal facilities, industrial site remediation

**Air quality:**
Street paving and roadway improvements, ports of entry, public transportation, methane capture, industrial emissions

**Cleaner / renewable energy:**
Solar, wind, biogas, biofuels, hydroelectric, geothermal

**Energy efficiency:**
Industrial equipment retrofits, public lighting & building upgrades

## Box 2: Board of Directors

**United States**

Secretary of the Treasury*

Secretary of State

Administrator of the Environmental Protection Agency

U.S. border state representative

U.S. border resident representative

**Mexico**

Secretary of Finance and Public Credit

Secretary of Foreign Relations

Secretary of Environment and Natural Resources

Mexican border state representative

Mexican border resident representative

* Board chair, 2014

**Loan Program:** The Bank takes a conservative approach to lending. For that reason, it performs a thorough due-diligence analysis of the technical and financial viability of each project considered for loan financing. In the case of certain borrowers and projects, this in-house analysis is further supported by external advisors who examine and structure the loans from a legal, technical, and financial perspective. The Bank negotiates individual loan agreements based on its policies and the needs of a particular borrower or project. Loan disbursements are made subject to the fulfillment of conditions set forth in each individual loan agreement.

Loans are generally offered at fixed or variable market rates, payable monthly, quarterly or semi-annually and with maturities of up to 25 years. For U.S. borrowers, loans are available in U.S. dollars. For Mexican borrowers, loans are available in Mexican pesos or in U.S. dollars if the project generates sufficient revenue in U.S. dollars to service the debt. For loans made in Mexican pesos, the Bank's exchange rate risk is fully hedged through cross-currency swaps. Loans are also generally secured by some form of credit support.

Loans may be made to public and private borrowers. Consistent with NADB's risk management philosophy, private borrower lending is subject to an even more stringent analysis and credit enhancement requirements. The Bank also supports public-private partnerships as a sound means of financing public infrastructure, especially for water supply and wastewater treatment projects. In most cases these partnerships are implemented through a build-operate-transfer (BOT) agreement, where the private contractor is the borrower and the municipality or utility serves as the source of payment and/or guarantor.

The Bank may act as sole lender or co-finance projects with other public or private financiers, depending upon the characteristics and financing needs of a project. In its early years, almost all of the Bank's co-financed projects were through a consortium with other governmental lenders, mainly in the wastewater sector. More recently, the Bank has participated in several project finance transactions with a co-financing structure where it will be repaid *pari passu* and share collateral pro-rata with the other lenders. The Bank is looking to participate in more co-financing structures of this nature, which will allow it to support larger projects while limiting its credit exposure.

As a matter of prudent risk management, the Bank also imposes limits per project and per borrower. In general, NADB cannot lend a project more than 85% of the eligible project costs. As amended in May 2013, the single obligor limit (SOL) is set at 20% of the Bank's usable equity (funded, unimpaired paid-in capital, plus undesignated retained earnings, the Special Reserve, and the Capital Preservation Reserve). An additional 10% may be made available for obligors that meet certain risk-related criteria. As of December 31, 2013, usable equity totaled US$478.31 million, resulting in a 20% SOL of US$95.66 million and a 30% SOL of US$143.49 million. At the close of 2014, usable equity had increased to US$493.61 million, raising the 20% SOL to US$98.72 million and the 30% SOL to US$148.08 million.

**Box 3: Grant Programs**

CAP:
Grants for up to US$500,000 are available for public-sector projects in low-income communities in all environmental sectors eligible for NADB financing, with priority given to drinking water, wastewater, water conservation and solid waste infrastructure.

TAP:
Grants for up to US$350,000 are available to fund studies and other activities related to project development and institutional capacity-building measures aimed at achieving the effective and efficient operation of public services. Training in the financial administration and planning of water utilities and other project-related seminars are also provided through the Utility Management Institute (UMI).

WCIF:
US$80-million grant program to support the implementation of water efficiency and conservation efforts along the border, which was formally terminated in 2013. Once the last four projects funded under the program have been completed, the WCIF will be fully closed out and any unused funds will be rolled over to the CAP.

**Grant Programs:** NADB uses a portion of its retained earnings to finance grant and technical assistance programs in support of its mandate. These funds may be designated by the Board as needed and are subject to availability. NADB had two grant programs in 2014: the Community Assistance Program (CAP) and the Technical Assistance Program (TAP). The objectives and funding limits of each program are described in Box 3, along with the Water Conservation Investment Fund (WCIF), which was formally terminated in 2013 and is in the process of being closed out.

NADB also administers grant funds provided by EPA through the Border Environment Infrastructure Fund (BEIF) for priority water and wastewater projects. These funds are received from EPA prior to disbursement by the Bank to the grantees, and any BEIF-related operating expenses incurred by the Bank are reimbursed by EPA. Consequently, these funds are reflected in NADB's consolidated financial statements, but have no economic effect on its operations. During the years ended December 31, 2014 and 2013, BEIF grant disbursements to project sponsors totaled US$14.67 million and US$17.46 million, respectively. During the same period, NADB recognized US$1.04 million and US$1.21 million, respectively, as reimbursement for administrative expenses incurred in running the program.

**Domestic Programs:** In addition to its environmental mandate, under the Charter, the two governments allocated ten percent of the Bank's subscribed capital to finance community adjustment and investment projects throughout the U.S. and Mexico in support of the purposes of the North American Free Trade Agreement (NAFTA). A completely separate program was established in each country. In the case of the Mexican domestic program, the funds were transferred in full to the Mexican government, but at the request of the U.S. government, NADB continues to hold and administer the funds of the U.S. domestic program. Consequently, its accounts are consolidated with those of NADB's international program. However, the U.S. domestic program's operations and allocated capital funding are completely independent of the Bank's international program, and any net income earned by the program and its profits, losses, expenses and disbursements do not affect the Bank's retained earnings or paid-in capital. The supplementary information provided at the end of the consolidated financial statements includes combining statements that show the breakdown of the international and domestic accounts.

The U.S. domestic program called, Community Adjustment and Investment Program (USCAIP), was designed to assist communities and the private sector in creating new jobs and preserving existing jobs in areas adjusting to changes in their economies as a result of NAFTA. USCAIP operates under the direction of a Finance Committee that is comprised of representatives of the U.S. Departments of the Treasury, Agriculture (USDA), and Housing and Urban Development (HUD), and the U.S. Small Business Administration (SBA), along with other agencies selected by the Department of the Treasury, which serves as Finance Committee chair. NADB disburses USCAIP funds under the direction of the Finance Committee, which is responsible for endorsing all financing decisions under USCAIP.

In January 2009, the Finance Committee determined that the best way to use the remaining USCAIP capital and have the greatest possible impact on USCAIP eligible communities would be principally through a Targeted Grant Program. During 2014, US$1.44 million in grants was disbursed through this program, and five new grants totaling US$0.85 million were awarded. During the same period, one loan was repaid in full. As of December 31, 2014, USCAIP had two loans with an outstanding balance of US$0.69 million. Expenditures directly related to the operation of the U.S. domestic program are paid out of its capital funds. Expenditures for the years ended December 31, 2014 and 2013 totaled US$0.30 million and US$0.29 million, respectively.

For more information about the U.S. domestic program, see Note 8 in the consolidated financial statements or visit the USCAIP website at www.nadbank-caip.org.

Unless otherwise specified, the information contained in this report pertains solely to the Bank's international program.

# Table 1: Financial Summary 2010-2014[1]

(US$ Thousands)

| | 2014 | 2013 | 2012 | 2011 | 2010 |
|---|---|---|---|---|---|
| **Operational Highlights** | | | | | |
| Loan commitments signed | $304,323 | $349,881 | $559,120 | $105,908 | $129,014 |
| Loan disbursements | 254,163 | 214,964 | 501,500 | 80,347 | 171,796 |
| Loan repayments | 76,122 | 73,733 | 52,753 | 122,811 | 12,141 |
| Undisbursed portion of committed loans | 126,985 | 238,780 | 119,819 | 62,199 | 44,903 |
| **Balance Sheet Data** | | | | | |
| Cash and cash equivalents | $85,086 | $56,810 | $62,357 | $36,778 | $38,403 |
| Investments | 357,868 | 488,715 | 326,217 | 313,791 | 236,040 |
| Loans outstanding[2] | 1,185,514 | 1,011,212 | 869,981 | 427,750 | 470,214 |
| Total assets | 1,633,369 | 1,573,076 | 1,302,304 | 820,018 | 754,399 |
| Borrowings outstanding, gross | 1,059,953 | 1,046,386 | 730,000 | 250,000 | 250,000 |
| Total liabilities | 1,090,683 | 1,054,422 | 780,457 | 286,822 | 261,421 |
| Total equity | 542,686 | 518,654 | 521,848 | 533,197 | 492,978 |
| Callable capital | 2,295,000 | 2,295,000 | 2,295,000 | 2,295,000 | 2,295,000 |
| **Income Statement Data** | | | | | |
| Loan income | $38,487 | $35,149 | $19,344 | $20,994 | $20,512 |
| Investment income | 5,412 | 4,386 | 7,779 | 6,907 | 11,400 |
| Other income | 1,056 | 46 | 590 | 9,420 | 529 |
| Operating expenses | 13,153 | 20,377 | 11,407 | 10,397 | 8,733 |
| Administrative expenses[3] | 8,567 | 8,871 | 8,425 | 7,999 | 6,768 |
| Provision for loan losses | 2,199 | 10,544 | - | 2,350 | 900 |
| Other expenses | 2,387 | 962 | 2,982 | 48 | 1,065 |
| Interest expense | 13,548 | 10,838 | 5,363 | 4,532 | 4,095 |
| Litigation expense | - | - | 1,484 | - | - |
| Income before grant program activity | 18,254 | 8,366 | 9,458 | 22,392 | 19,613 |
| Program expenses[4] | 2,077 | 1,145 | 2,437 | 737 | 2,121 |
| Net income | 16,177 | 7,221 | 7,020 | 21,655 | 17,492 |
| **Ratios** | | | | | |
| Adjusted shareholders' equity[5] / loans outstanding | 44.2% | 49.3% | 57.5% | 119.2% | 101.2% |
| Gross debt / callable capital | 46.2% | 45.6% | 31.8% | 10.9% | 10.9% |
| Gross debt / adjusted shareholders' equity | 202.4% | 210.1% | 145.8% | 49.0% | 52.5% |
| Interest coverage[6] | 2.7x | 2.8x | 3.6x | 6.5x | 6.3x |
| Liquid assets / total assets | 23.8% | 31.3% | 25.7% | 36.3% | 29.3% |
| Operating income / adjusted shareholders' equity | 3.5% | 1.7% | 1.9% | 4.4% | 4.1% |
| Operating income / average assets | 1.1% | 0.6% | 0.9% | 2.8% | 3.2% |

[1] Excludes the U.S. domestic program (see page 5).

[2] Before allowance for loan losses, unamortized fees, and effect of foreign exchange adjustments and hedged items.

[3] Administrative expenses is defined as the sum of personnel, consultants, operational travel and general and administrative.

[4] Program expenses include grant financing and technical assistance funded from the Bank's retained earnings, but excludes the Border Environment Infrastructure Fund (BEIF), which is fully funded by the U.S. Environmental Protection Agency.

[5] Adjusted shareholder' equity is defined as the sum of undesignated paid-in capital, undesignated retained earnings, reserves, and accumulated other comprehensive income.

[6] Interest coverage ratio is defined as total revenue minus administrative expenses divided by interest expense.

## Financing Operations

### Lending Activity

New loan commitments totaling US$323.67 million were approved for eight projects in 2014, an increase of 18.5% compared to loan approvals of US$273.24 million for 11 projects in 2013. Five of the new loan commitments approved in 2014 were contracted before year-end, along with four commitments approved in previous years. Altogether, nine loan agreements totaling US$304.32 million were signed in 2014, a 13.0% decrease compared to the 11 loans for US$349.88 million contracted in 2013. At the close of 2014, an estimated US$145.11 million in approved loan commitments was pending contracting, as compared to US$123.74 million in 2013.

A five-year summary of the Bank's lending activity is provided in Table 1. Over the past five years, loan signings have averaged US$289.65 million per year.

**Table 2: Loan Commitments Approved** (US$ Millions)

| Sector | 2014 | 2013 |
|---|---|---|
| Air quality/roadway improvements | **$ 46.16** | $ 8.60 |
| Basic urban infrastructure* | - | 19.10 |
| Landfill gas-to-energy | - | 3.07 |
| Public transportation | **9.12** | - |
| Solar energy | **41.08** | 192.47 |
| Water / wastewater | **1.54** | - |
| Water conservation | **30.77** | - |
| Wind energy | **195.00** | 50.00 |
| Total | **$ 323.67** | $ 273.24 |

A breakdown of the loans approved and contracted by sector for the past two years is shown in Tables 2 and 3, respectively. As highlighted in these charts, efforts to break into new areas were rewarded in 2014 as the Bank contracted its first loans for a landfill gas-to-energy project and a public transportation project for the purchase and/or lease of low-emission buses, as well as approved its first loan to support a water conservation project for an irrigation district.

**Table 3: Loan Commitments Signed** (US$ Millions)

| Sector | 2014 | 2013 |
|---|---|---|
| Air quality/roadway improvements | **$ 30.82** | $ 136.53 |
| Basic urban infrastructure* | - | 19.10 |
| Landfill gas-to-energy | **2.61** | - |
| Public transportation | **9.12** | - |
| Solar energy | **81.08** | 169.99 |
| Water / wastewater | **1.54** | 24.26 |
| Wind energy | **179.15** | - |
| Total | **$ 304.32** | $ 349.88 |

Loan disbursements increased 18.2% to a total of US$254.16 million in 2014 (compared to US$214.96 million in 2013) and included the full or partial disbursement of all but one of the loans contracted during the year. At the end of 2014 an estimated US$126.99 million in contracted loan commitments was pending disbursement, as compared to US$238.78 million in 2013.

**Table 4: Loan Disbursements** (US$ Millions)

| Sector | 2014 | 2013 |
|---|---|---|
| Air quality/roadway improvements | **$ 30.82** | $ 10.64 |
| Basic urban infrastructure* | **3.28** | 11.08 |
| Landfill gas-to-energy | **2.61** | - |
| Solar energy | **103.02** | 122.06 |
| Water / wastewater | **37.56** | 33.77 |
| Wind energy | **76.88** | 37.41 |
| Total | **$ 254.16** | $ 214.96 |

* These projects consist of a mix of works from different sectors, such as water, wastewater, storm drainage and roadway improvements.

A breakdown of disbursements by sector during 2014 and 2013 is shown in Table 4. Loan funds flowed in a similar pattern both years, with the majority going to solar energy projects, followed by wind energy and water-related projects. In 2014, solar energy accounted for 40.5% of disbursements, down from 56.8% in 2013; while wind energy represented 30.2%, nearly double the percentage in 2013 (17.4%); and water and wastewater loans remained fairly stable at 14.8%, compared to 15.7% in 2013.

Private-sector borrowers in the U.S. accounted for 40.5% of the disbursed loans in 2014, while the remaining 59.5% went to projects in Mexico and was divided among public-sector (1.3%), private-sector (31.3%) and public-private borrowers (26.9%). In comparison, 74.2% of the loans disbursed in 2013 went to private-sector borrowers in the U.S., and the remaining

25.8% to projects in Mexico, of which 16.9% went to governmental borrowers and 8.9% to public-private partnerships. This shift in borrowers reflects the growing interest of private companies to invest in renewable energy in Mexico, as well as Mexican municipalities and water utilities seeking partnerships with the private sector in order to provide public services.

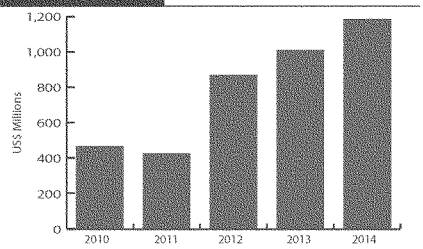
Principal payments totaled US$76.12 million in 2014, including the prepayment of one loan for US$1.14 million. In comparison, the Bank received US$73.73 million in principal payments in 2013, which included US$12.36 million for the prepayment of three loans. Excluding prepayments, principal payments increased 22.2% between 2013 and 2014 and have grown at an average annual rate of 62.8% since December 2010 as a result of the steady growth of the loan portfolio.

## Loan Portfolio

As of December 31, 2014, the Bank had an outstanding loan balance of US$1.19 billion, an increase of 17.2% over the balance at the end of 2013 (US$1.01 billion). The Bank registered a similar increase of 16.2% in 2013 from a balance of US$869.98 million at the close of 2012.

Since December 31, 2010, the loan portfolio has grown at an average annual rate of 26.0%. However, as shown in Figure 1, in the past couple of years, portfolio growth has leveled off, increasing at a more moderate average rate of 16.7% per year.

**Figure 1:** Annual Loan Portfolio Performance




Changes in the monetary value of loans by environmental sector during the 12-month period ending December 31, 2014 are provided in Table 5. All of the sectors registered steady growth with the exception of storm drainage and basic urban infrastructure, both of which declined as a result of principal payments. Solar energy registered the largest monetary increase with US$73.91 million, followed by wind energy with US$60.60 million and water and wastewater with US$29.41 million.

Nevertheless, as illustrated in Figure 2, the distribution of loans by environmental sector for the years ending in 2013 and 2014 remained very stable with minimal changes. The most significant changes were a 2.3% increase in solar energy, a 1.2% decline in storm drainage and a 0.9% decline in basic urban infrastructure.

**Table 5:** Outstanding Loans by Environmental Sector (US$ Millions)

| | 12/31/2014 | 12/31/2013 | % Change |
|---|---|---|---|
| Wind energy | **$ 430.53** | $ 369.93 | 16.4% |
| Solar energy | **341.53** | 267.62 | 27.6% |
| Water/wastewater | **188.25** | 158.84 | 18.5% |
| Air quality/roadway improvements | **136.22** | 118.62 | 14.8% |
| Storm drainage | **62.86** | 66.06 | -4.8% |
| Basic urban infrastructure* | **23.51** | 29.00 | -18.9% |
| Other clean energy | **2.61** | 1.14 | 128.9% |
| Total | **$ 1,185.51** | $ 1,011.21 | |

* Basic urban infrastructure includes a mix of street paving, water and sewer lines, and storm drainage.

At the close of 2014 and 2013, wind energy accounted for the largest portion of the loan portfolio at 36.3% and 36.6%, respectively; followed by solar energy with 28.8% and 26.5%, respectively; and water and wastewater with 15.9% and 15.7%, respectively.

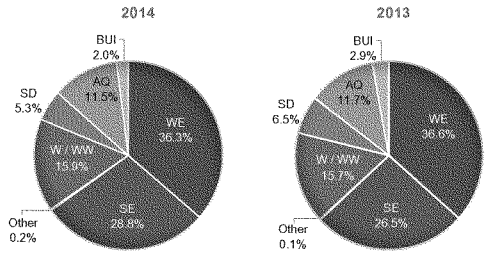
Given that the border region offers ideal conditions for solar and wind energy projects, the Bank expects to see continued demand for loans in those sectors. Of the US$126.99 million in signed loan commitments pending disbursement at the end of 2014, just over 80% (US$103.10 million) is destined for renewable energy projects. However, the Bank continues

to pursue projects in other areas. Of the US$145.78 million in approved loan commitments pending contracting at the end of 2014, 62.1% (US$90.11 million) is intended for projects related to air quality, water conservation and wastewater treatment.

In terms of borrowers, the loan portfolio is broken down into three categories: public, private or public-private. In the latter case, a private company is the direct borrower, but the source of payment and/or guaranty is a public utility or local government and the Bank has recourse to both the private and public entity.

During 2014, the volume of loans held by private-sector borrowers increased US$132.70 million to US$774.67 million, mainly as a result of increased lending in the renewable energy sector. During the same period, the volume of loans held by public-sector borrowers decreased US$25.61 million to US$319.77 million, which can partly be attributed to the increasing number of local governments and utilities seeking to provide public services and infrastructure through public-private partnerships. Loans held by public-private borrowers totaled US$91.07 million in 2014, an increase of US$67.21 million over the prior year total of US$23.86 million. A breakdown of the loan portfolio by borrower type at the close of 2013 and 2014 is shown in Figure 3.

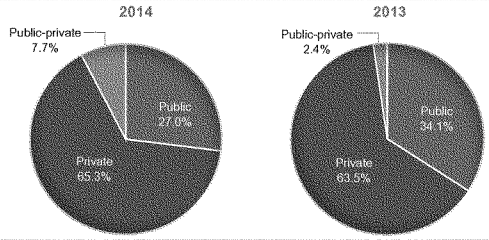
**Figure 2:**
Breakdown of Loan Portfolio by Environmental Sector




* Air Quality (AQ), Basic Urban Infrastructure (BUI), Storm Drainage (SD), Solar Energy (SE), Water/ Wastewater (W/WW), Wind Energy (WE)

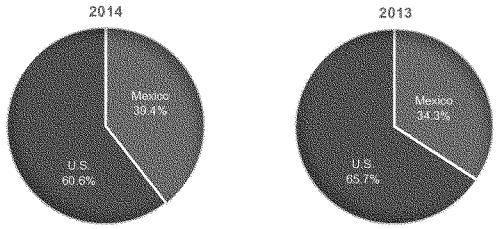
** Other included biofuel in 2013 and landfill gas-to-energy in 2014.

**Figure 3:**
Breakdown of Loan Portfolio by Borrower Type



In terms of portfolio distribution by geographic region, investment in projects in Mexico grew more rapidly than in the United States in 2014, reversing the trend of the previous two years. Loans invested in Mexican projects grew by 34.7% (US$120.41 million) to a total of US$466.96 million in 2014, compared to an increase of 3.3% (US$11.07 million) in 2013, while the amount held by U.S. borrowers increased 8.1% (US$53.89 million) to a total of US$718.55 million, compared to an increase of 24.4% (US$130.16 million) the previous year. Figure 4 illustrates the breakdown of the loan portfolio by country at the close of 2013 and 2014. This new growth trend is expected to continue as lending activity in Mexico tends to cover a broader array of sectors than in the United States, where borrowers have access to more financing options.

**Figure 4:**
Breakdown of Loan Portfolio by Region




As indicated in Table 6, during 2014, new lending activity was spread across eight of the ten border states within the Bank's geographic jurisdiction. While the largest monetary investment was made in Baja California with new loans totaling US$48.05 million, the most noteworthy changes occurred in Chihuahua, where outstanding loans more than quadrupled from US$9.04 million to US$40.11 million, followed by Nuevo Leon where outstanding loans more than doubled from US$28.85 million to US$62.87 million.

As a result of this lending activity, the loan portfolio is becoming more evenly distributed by state (see Figure 5). Although the majority of the loan portfolio continues to be concentrated in the same three states, the level of concentration declined from 73.4% in 2013 to 66.5% in 2014. At the close of 2014, Texas accounted for 28.1% of the loan portfolio, down from 31.0% at the beginning of the period, followed by California with 25.0% (compared to 26.0% in 2013) and Tamaulipas with 13.4% (compared to 16.4% in 2013).

**Table 6:**
Outstanding Loans by State*
(US$ Millions)

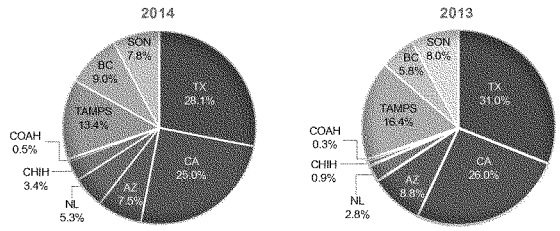
| | 12/31/2014 | 12/31/2013 | % Change |
|---|---|---|---|
| Texas | **$ 333.82** | $ 313.20 | 6.6% |
| California | **295.92** | 262.92 | 12.6% |
| Tamaulipas | **158.67** | 165.64 | -4.2% |
| Baja California | **107.01** | 58.96 | 81.5% |
| Sonora | **92.94** | 81.08 | 14.6% |
| Arizona | **88.81** | 88.54 | 0.3% |
| Nuevo Leon | **62.87** | 28.85 | 117.9% |
| Chihuahua | **40.11** | 9.04 | 343.7% |
| Coahuila | **5.36** | 2.98 | 79.9% |
| Total | **$ 1,185.51** | $ 1,011.21 | |

* Includes loans to both public and private borrowers.

All of the Bank's current lending is made at market rates. However, in prior years, NADB was authorized to offer below-market interest rate lending on a limited basis for public projects in the water and solid waste sectors. At the close of 2014, US$46.81 million of outstanding loans were at below-market rates, representing 3.9% of the total portfolio.

The Bank funds loans with its equity or borrowed monies. Under its charter, the total amount of outstanding loans (and guaranties) may not at any time exceed the total amount of unimpaired subscribed capital of the Bank, plus the unimpaired reserves and undistributed surplus that are included in its capital resources. As of December 31, 2014, the total unimpaired subscribed capital of the Bank was US$2.70 billion (paid-in capital and callable capital allocated to the international program) and its unimpaired reserves and undesignated retained earnings came to US$119.00 million, for a total loan limit of US$2.82 billion, an increase of US$17.88 million (0.6%) over the loan limit of US$2.80 billion at the end of 2013.

**Figure 5:**
Breakdown of Loan Portfolio by State




***Non-performing Loans:*** The Bank monitors the credit quality of its borrowers on an ongoing basis and may suspend the disbursement of a loan in the event a weakness is identified that jeopardizes repayment in compliance with the contractual terms. The Bank generally classifies loans as non-performing when payments of principal or interest on the loan are delinquent for 90 days or more, or where reasonable doubt exists as to the borrower's ability to make timely payment. Loans are generally placed in nonaccrual status when principal or interest is delinquent for 180 days or more, or where reasonable doubt exists as to timely collection. The Bank evaluates credit recovery actions on a case-by-case basis and negotiates with delinquent borrowers to recover amounts due. In certain cases where a borrower experiences financial difficulties, the Bank may seek to restructure the contractual terms of the loan.

Of the 67 loans outstanding at the close of 2014, one was classified as non-performing with a balance of US$3.39 million, representing 0.3% of the loan portfolio. In comparison, two of the 61 loans outstanding at the close of 2013 were classified as non-performing with a balance of US$6.98 million.

In the event that the full repayment of a loan is deemed doubtful, the Bank allocates a specific allowance for probable and estimable loan losses on its financial statements. As of December 31, 2014 and 2013, the Bank had a specific allowance for loan losses of US$0 and US$3.44 million, respectively. The Bank also provides a general allowance for loan losses for private-sector borrowers based on statistical cumulative default and recovery rates for project finance loans. As of December 31, 2014 and 2013, the general allowance totaled US$11.36 million and US$9.45 million, respectively.

## Grant Activity

During 2014, three grants totaling US$0.77 million were approved through the Community Assistance Program (CAP), and two of those grants totaling US$0.32 million were contracted by year end. In comparison, five CAP grants totaling US$2.18 million were approved and contracted in 2013. New grant commitments for infrastructure projects averaged US$0.79 million annually during the past five years.

With respect to the Technical Assistance Program (TAP), NADB approved US$0.49 million for eight studies in 2014 and US$0.57 million for five studies in 2013. During the past five years, new grant approvals for technical assistance projects have averaged US$0.52 million annually. Additionally, through the Utility Management Institute (UMI), NADB sponsored seven training seminars in 2014 and 19 in 2013.

**Table 7:**
Grant Disbursments
(US$)

| Program | For the Years Ended 12/31/2014 | 12/31/2013 |
|---|---|---|
| CAP | **$ 796,259** | $ - |
| TAP | **380,650** | 261,047 |
| UMI | **378,419** | 428,818 |
| WCIF | **521,904** | 455,025 |
| Total | **$ 2,077,232** | $ 1,144,890 |

Disbursements of NADB-funded grants for studies, training and project implementation for the years ended December 31, 2014 and 2013 came to US$2.08 million and US$1.14 million, respectively. Over the past five years, grant disbursements have averaged US$1.70 million annually. A breakdown of grant disbursements by program for the past two years is shown in Table 7. These grant disbursements were funded with previously designated retained earnings and are reported as program expenses in the consolidated income statement.

A small portion of CAP funding is used to cover the supervision costs of projects financed under the program. A cumulative total of US$0.25 million and US$0.17 million were committed to construction supervision contracts as of December 31, 2014 and 2013, respectively. For the years ended in those same dates, a total of US$0.12 million and $0, respectively, had been expended under supervision contracts and is included as a component of the CAP grant disbursements shown in Table 7.

At the end of 2014, there was a balance of approximately US$5.31 million in committed grant funds pending disbursement: US$3.30 million from the Water Conservation Investment Fund (WCIF), US$1.82 million from CAP and US$0.19 million in TAP funds.

For fiscal years 2014 and 2013, US$0.45 million from undesignated retained earnings was allocated to the technical assistance program for training purposes. No new funding was allocated to the CAP for project financing during 2014 and 2013. Therefore, as of December 31, 2014, NADB had a balance of US$8.27 million in uncommitted CAP funding available for future projects and US$4.71 million in TAP funds available for studies.

## Funding Resources

NADB funds its lending activities and general operations with equity (paid-in capital and retained earnings) and the proceeds from borrowings. As of December 31, 2014, total equity under the international program was US$542.69 million, an increase of 4.6% compared to US$518.65 million at the close of 2013.

### Capitalization

The total authorized capital of NADB is US$3 billion with equal commitments from its two member countries, the United States and Mexico. Each government authorized the subscription of 150,000 shares of the Bank's capital stock with a par value of US$10,000 per share. Fifteen percent of NADB's authorized capital is in the form of paid-in capital and the remaining 85% is callable capital.

***Paid-in capital:*** Paid-in capital totals US$450 million and consists of cash funds contributed to NADB by the U.S. and Mexico. As set forth in its Charter at inception, 10% of the paid-in capital and associated callable capital subscribed by each country went to finance the domestic programs. Therefore, of the US$450 million in paid-in capital, US$45 million was transferred to the domestic programs for community adjustment and investment, leaving US$405 million for NADB's international program.

The paid-in capital for the domestic programs was divided equally between the two countries with each receiving US$22.50 million for its respective program. The balance of paid-in capital and related earnings for the Mexican domestic program was subsequently transferred to the Mexican federal government as of June 1999. In the case of the U.S. domestic program, NADB continues to hold and administer the balance of its paid-in capital and related earnings. As of December 31, 2014, US$4.34 million in paid-in capital was allocated to USCAIP and held in the Bank's General Reserve.

***Callable capital:*** Callable capital totaling US$2.55 billion—with US$255 million related to the domestic programs and the remaining US$2.295 billion to the international program—is composed of funds that must be provided to NADB by the two governments if required to meet its outstanding debt obligations or guaranties. Callable capital may not be used for loans or investments and constitutes, in effect, backing for the Bank's outstanding indebtedness and guaranties.

The subscription of US$1.275 billion of callable capital stock has been authorized by both governments through their respective legislatures and will be appropriated, if needed. Any capital call must be made uniformly to both member countries, but the obligations of the U.S. and Mexico to make payment of the callable portion of their capital subscriptions to the Bank are independent of each other. As a result, the failure of one member country to make payment on any such call would not excuse the other member from its obligation to make payment and, if necessary, the Bank may make successive calls on the non-defaulting member, up to its subscribed callable capital limit. Neither member country may be required to pay more than the unpaid balance of its capital subscription.

**Box 4:**
**Reserve Funds under the International Program**

Debt Service Reserve:
Maintained in an amount equal to 12 months of interest due on the Bank's outstanding debt at each fiscal year-end.

Operating Expenses Reserve:
Maintained in an amount equal to 12 months of the operating budget expenses at each fiscal year-end.

Special Reserve:
Maintained in an amount equal to the sum of 1% of undisbursed loan commitments, 3% of the outstanding balance of disbursed loans, and 3% of the outstanding balance of guaranties, less the general allowance for loan losses with a targeted minimum of US$30 million.

Capital Preservation Reserve:
Indexed to the U.S. annual inflation rate in order to maintain the value of the paid-in capital in real terms.

## General Reserve

The Bank maintains a General Reserve funded in an amount equal to the retained earnings of NADB, plus transfers from paid-in capital for the U.S. domestic program. As of December 31, 2014 and 2013, the General Reserve balance was US$141.07 million and US$126.59 million, respectively, of which approximately US$137.87 million and US$121.70 million, respectively, related to the Bank's retained earnings under the international program. The remaining balances of US$3.20 million and US$4.89 million represented the allocated paid-in capital and retained earnings of the U.S. domestic program as of December 31, 2014 and 2013, respectively.

Retained earnings are classified as reserved for a specific purpose, designated to a specific program or undesignated. Under the international program NADB maintains four reserves, which are described and funded in the order of priority shown in Box 4.

Annual allocations from undesignated retained earnings to the reserve funds are made as necessary, and if available, to maintain the levels mandated under the retained earnings policy. Allocations of undesignated retained earnings to programs may be made with Board approval only after full funding of the reserves. Table 8 provides a breakdown of the retained earnings allocated to reserves and programs at the end of fiscal years 2014 and 2013.

During 2014, retained earnings grew 13.3% to a total of US$137.87 million, while the amount allocated to reserves increased US$9.50 million (11.2%), mainly as a result of capital preservation requirements, and the amount designated to programs decreased US$1.70 million (8.3%) due to grant disbursements. With US$94.60 million of the retained earnings allocated to

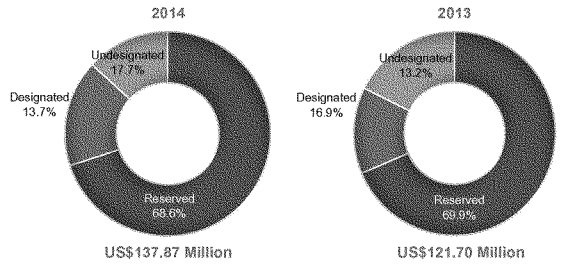
**Table 8:**
Reserved and Designated Retained Earnings under the International Program
(US$ Millions)

| | 12/31/2014 | 12/31/2013 |
|---|---|---|
| **Reserved retained earnings** | | |
| Debt Service Reserve | **$ 19.99** | $ 18.43 |
| Operating Expenses Reserve | **10.40** | 9.38 |
| Special Reserve | **30.00** | 30.00 |
| Capital Preservation Reserve | **34.21** | 27.30 |
| Total reserves | **$ 94.60** | $ 85.11 |
| **Designated retained earnings** | | |
| Community Assistance Program (CAP) | **$ 10.68** | $ 11.47 |
| Water Conservation Investment Fund (WCIF) | **3.30** | 3.82 |
| Technical Assistance Program (TAP) | **4.90** | 5.29 |
| Total designated | **$ 18.88** | $ 20.58 |

reserves and US$18.88 million designated to fund programs, the Bank had US$24.39 million in undesignated retained earnings at the end of 2014, which represents an increase of 52.3% (US$8.38 million) over the balance of undesignated retained earnings held at the end of 2013 (US$16.01 million).

The Special Reserve may be used to offset losses on outstanding loans or to pay expenses relating to the enforcement of the Bank's rights under outstanding loan and guaranty agreements. The U.S. domestic program may also allocate funding to this reserve for its loans. As of December 31, 2014 and 2013, special reserves allocated to the U.S. domestic program totaled US$20,752 and US$34,667, respectively.

**Figure 6:**
Retained Earnings under the International Program




## Borrowings

NADB may raise funds by issuing debt in international capital markets or with other financial institutions for the purpose of financing its lending operations or refinancing existing borrowings. The Bank's annual borrowing plan is approved by the Board of Directors. In accordance with its debt limit policy, total principal outstanding may not exceed at any time the callable portion of its subscribed capital shares associated with the international program, plus the minimum liquidity level required under the liquidity policy. With US$2.295 billion in subscribed callable capital associated with the international program and a minimum liquidity level of US$185.50 million for 2014, the Bank's maximum debt limit during 2014 was US$2.48 billion. This figure is slightly higher than the maximum debt limit of US$2.46 billion in 2013, as the Bank had a lower minimum liquidity requirement for 2013 (US$164.00 million). At the close of 2014, the Bank had total debt outstanding of US$1.06 billion, accounting for 42.7% of its debt limit.

The Bank did not issue any new debt in the capital markets during 2014; however, under a fixed-rate loan agreement for up to US$50 million contracted with another development bank in November 2012, NADB drew down US$13.57 million during 2014 to fund eligible wastewater projects in Mexico. In October 2013, the Bank issued a five-year non-amortizing note with a face value of US$300.00 million at a fixed coupon rate that generated proceeds of US$298.21 million. NADB also drew down US$16.39 million on the aforesaid loan agreement for Mexican wastewater projects in 2013.

Gross outstanding debt increased 1.3% to a total of US$1.06 billion in 2014, from US$1.05 billion at the close of 2013. All borrowings have been issued at fixed rates in U.S. dollars. A breakdown of the borrowings by type and maturity is shown in Tables 9 and 10, respectively. Most of the Bank's fixed-rate debt is hedged through interest rate swaps, effectively changing it to floating rates.

**Table 9:**
Gross Debt by Type
(US$ Millions)

| | 12/31/2014 | 12/31/2013 |
|---|---|---|
| Notes payable | **$ 1,030.00** | $ 1,030.00 |
| Other borrowings | **29.95** | 16.39 |
| Total | **$ 1,059.95** | $ 1,046.39 |

**Table 10:**
Gross Debt by Maturity
(US$ Millions)

| | 12/31/2014 | 12/31/2013 |
|---|---|---|
| Short-term | **$ 2.63** | $ - |
| Long-term | **1,057.32** | 1,046.39 |
| Total | **$ 1,059.95** | $ 1,046.39 |

In February 2014, under its revised methodology for multilateral development banks and other supranational entities, Moody's Investors Service issued NADB an Aa1/P-1 rating with a stable outlook, reflecting its strong capitalization and liquidity levels, conservative risk management policies and the expectation of strong shareholder support in the event of financial stress. In April 2014, Fitch Ratings reaffirmed its AA/F1+ credit rating of NADB with a stable outlook.

## Results of Operations

**Table 11:**
Operating Income & Expenses under the International Program
(US$ Millions)

The main source of revenue for NADB is derived from interest income on its loan portfolio and investment holdings. Expenses mainly consist of interest paid on borrowed funds, personnel and administrative costs, provisions for loan losses and net unrealized losses from hedging activities.

| | For the Years Ended 12/31/2014 | 12/31/2013 |
|---|---|---|
| Loan interest income | **$ 38.49** | $ 35.15 |
| Investment interest income | **5.22** | 4.39 |
| | **43.71** | 39.54 |
| Less: interest expense | **13.55** | 10.84 |
| Net interest income | **30.16** | 28.70 |
| Gain (loss) on sales of investments, net | **0.19** | (0.01) |
| Other income | **1.06** | 0.05 |
| Total net revenue | **31.41** | 28.74 |
| Less: | | |
| Administrative expenses | **8.57** | 8.87 |
| Provisions for loan losses | **2.20** | 10.54 |
| Other expenses | **2.39** | 0.96 |
| Income before program activities | **$ 18.25** | $ 8.37 |

For the year ended December 31, 2014, the Bank had total revenue of US$44.95 million, total operating expenses of US$13.15 million, interest expense of US$13.55 million and income before program activities of US$18.25 million. Net income after program expenses (grant disbursements) was US$16.18 million. Table 11 provides a breakdown of the main operating income and expense categories for the years ended December 31, 2014 and 2013.

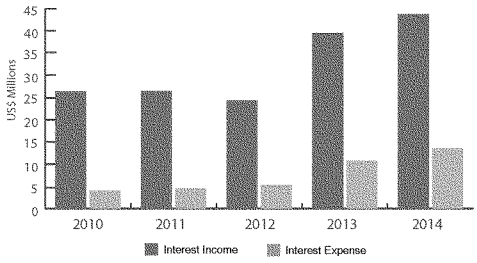
***Interest Income:*** For the year ended December 31, 2014, interest from loans totaled US$38.49 million, an increase of US$3.34 million or 9.5% over the previous year, reflecting the continued growth of the loan portfolio. Interest income on investments for the same period totaled US$5.22 million, an increase of US$0.83 million or 18.9% compared to the previous year. This increase can mainly be attributed to higher average investment balances deriving from the proceeds of a debt issuance received in the last quarter of 2013.

***Net Gain (Loss) on Investments:*** The net gain on sales of available-for-sale investment securities for the year ended December 31, 2014, was US$0.19 million, as compared to a net loss of less than US$0.01 million for the year ended December 31, 2013. Available-for-sale investment securities totaled US$304.20 million and US$435.10 million as of December 31, 2014 and 2013, respectively, representing a decrease of US$130.89 million or 30.1%. This reduction in investment holdings occurred as securities were sold to fund new loans.

***Other Income and Expenses:*** Other income and expenses generally consist of net foreign exchange gains (losses), net gains (losses) from swaps, loan fees, depreciation and other miscellaneous income and expenses. For the year ended December 31, 2014, other income totaled US$1.06 million as compared to US$0.05 million for the year ended December 31, 2013. The net increase is primarily attributable to a US$1.04 million increase in swap income. For the years ended December 31, 2014 and 2013, other expenses totaled US$2.39 million and US$0.96 million, respectively. The increase is mainly attributable to a US$1.53 million impairment in the fair value of other real estate owned.

***Interest Expense:*** Interest expense consists of the interest on US$1.06 billion and US$1.05 billion in debt as of December 31, 2014 and 2013, respectively, net of hedge effect. For the year ended December 31, 2014, interest expense totaled US$13.55 million as compared to US$10.84 million for the year ended December 31, 2013.

**Figure 7:** Interest Income vs. Interest Expense




***Provision for Loan Losses:*** In addition to specific loan loss provisions on non-performing loans, in November 2013, NADB began creating general provisions on loans made to private-sector borrowers based on probabilities of default and expected recovery rates. During 2013, the allowance for loan losses was increased by US$10.54 million, mainly due to a general provision for loan losses totaling US$9.45 million, as the Bank implemented its new general allowance policy. The remaining US$1.09 million was provisioned for a specific impaired loan. During 2014, the net provision for loan losses was US$2.20 million, which mainly consisted of a general provision for loan losses of US$1.90 million due to increased lending to the private sector, while the remaining US$0.30 million was provisioned for a specific impaired loan.

***Administrative Expenses:*** These expenses, which consist of personnel, consultants, travel, general and administrative costs, decreased 3.4%, from US$8.87 million in 2013 to US$8.57 million in 2014, mainly because of a significant increase in loan origination fees, which helped offset loan origination costs.

## Liquidity Management

NADB has established liquidity and investment policies to help ensure that it can meet its financial obligations at all times, even under conditions of constrained market access, as well as have sufficient cash flows to cover its operational needs in the normal course of business.

### Liquidity Policy

Under its liquidity policy, the Bank's minimum level of liquid holdings is equal to the highest consecutive 12 months of the following 18 months of expected debt service obligations, committed net loan disbursements and projected operating expenses for the relevant fiscal year. The minimum liquidity level is determined prior to the beginning of each fiscal year and may be revised during the year in the event of major changes in outlook. In accordance with this policy, the minimum liquidity balance for the 2014 fiscal year was US$185.50 million and for the 2015 fiscal year it will be US$147.70 million.

**Table 12:**
Liquid Assets under the International Program
(US$ Millions)

| Type of Security | For the Years Ended 12/31/2014 | 12/31/2013 |
|---|---|---|
| Cash and Cash Equivalents | **$ 85.09** | $ 56.81 |
| U.S. Treasury Securities | **106.17** | 176.81 |
| U.S. Agency Securities | **68.83** | 92.28 |
| Mortgage-backed Securities | **0.02** | 0.08 |
| United Mexican State (UMS) Securities | **15.06** | 18.37 |
| Taxable Municipal Securities | **3.05** | 5.08 |
| Other Permissible Securities* | **111.07** | 142.48 |
| Total | **$ 389.29** | $ 491.91 |

*Other permissible securities include corporate debt securities, asset-backed securities,commercial paper and certificates of deposit.

The Bank's liquid asset holdings are in the form of cash, cash equivalents (mainly repurchase agreements) and investments in longer term marketable securities (fixed-income securities). All of the investments held in the liquidity portfolio are designated as available-for-sale. As of December 31, 2014, 49.1% of the Bank's liquid asset portfolio was comprised of highly liquid assets (cash, cash equivalents and U.S. Treasuries). The remaining 50.9% was comprised of other types of liquid assets held by the Bank.

As of December 31, 2014 and 2013, liquid assets totaled US$389.29 million and US$491.91 million, respectively. The US$102.62 million decrease was primarily the result of loan disbursements. At the close of 2014, the Bank's liquid assets represented 23.8% of total assets (US$1,633.37 million) and 36.7% of total gross debt (US$1,059.95 million), as compared to 31.3% of total assets (US$1,573.08 million) and 47.0% of total gross debt (US$1,046.39 million), at the end of 2013.

### Investment Policy

The Bank's investment objectives are to ensure that its liquid assets are prudently invested to preserve capital and provide necessary liquidity. All of the Bank's investments are classified as held-to-maturity or available-for-sale securities.

The Bank invests in high quality, liquid securities which have readily identifiable prices. Permissible securities that otherwise meet the Bank's investment policy comprise a wide range of high-quality, fixed-income instruments, including U.S. Treasury and governmental agency securities, Mexican government securities, bank deposits, repurchase agreements (pursuant to master purchase agreements and fully collateralized by U.S. Treasury securities), certificates of deposit, commercial paper and money market funds.

The Bank is restricted from investing more than 5% of its investment portfolio in the securities of any one issuer, excluding obligations of the U.S. government, the Mexican government and U.S. government agencies. The investment portfolio must contain a minimum of 25% U.S. government securities; all other securities are subject to caps as indicated in Box 5.

The majority of the securities in which the Bank invests must be rated AA (or its equivalent) or higher by a recognized securities rating agency. There are only two exceptions: 1) Mexican government securities; and 2) corporate debt securities denominated in U.S. dollars and rated A (or its equivalent) or higher, which cannot exceed 25% of the total investment portfolio. Repurchase agreements, certificates of deposit and commercial paper counterparties must have a short-term debt rating of A-1 (or its equivalent) or higher by a recognized rating agency.

**Box 5:**
Investment Guidelines

| Securities | Established Limits |
|---|---|
| U.S. Treasury securities | 25% minimum |
| U.S. agency securities | 45% maximum |
| Mortgage-backed securities | 15% maximum |
| Mexican (UMS) securities | 30% maximum |
| Taxable municipal securities | 25% maximum |
| Other permissible securities | 35% maximum |

## Risk Management

As a part of its development financing services, the Bank is exposed to credit risk (loan portfolio or counterparty risk); market risk (interest rate and exchange rate); liquidity risk (funding and liquidation); and operational risk. The Bank manages its risks in accordance with the Charter and the policies approved by the Board of Directors. In general, NADB manages the risks inherent in its lending activities by ensuring that the projects it finances meet certain economic and feasibility criteria and by requiring some form of credit support if necessary. NADB's market risk is limited by its liquidity and investment policies. The Bank takes a conservative approach to market risk, which is neutralized or mitigated through the use of derivatives. The Bank engages in these transactions for the sole purpose of asset/liability risk management, and not for any speculative purposes.

### Credit Risk

The Bank is subject to certain credit risk related to the potential losses that could result from the default of borrowers (loan portfolio credit risk) or from the default of the Bank's investment, trading or swap counterparties (counterparty risk).

***Loan Portfolio Credit Risk:*** As a result of its core business of providing infrastructure development loans, the Bank is exposed to the risk that it may not receive payment of principal and/or interest on one or more of its loans in accordance with the agreed-upon terms. Loan portfolio credit risk is determined by the credit quality of each borrower and the Bank's exposure to each borrower. The Bank mitigates this credit-default risk by performing thorough credit analyses and applying stringent due-diligence procedures to projects and borrowers, as well as using tailor-made loan structures with strong payment mechanisms and adhering to strict debt service coverage requirements. In addition, the Bank has established policies limiting its exposure per project and per obligor, and continually monitors the financial stability of each borrower throughout the term of the loan.

To further mitigate this credit default risk, all of the loans in the Bank's outstanding portfolio are secured by some form of credit support, including project revenue, borrower cash flows, senior liens on project equity and assets, step-in rights or, in the case of Mexican loans, federal tax revenue pledged to an irrevocable trust or pursuant to a mandate agreement. In addition, the Bank maintains an allowance for loan losses, as well as a Special Reserve funded from its retained earnings, which are available to offset any losses on outstanding loans or pay expenses relating to the enforcement of the Bank's rights under outstanding loan agreements.

***Counterparty Risk:*** This risk arises from exposure to losses that could occur as a result of the default of one of the Bank's investment, trading or swap counterparties. The main sources of the Bank's counterparty risk are the financial instruments in which the Bank invests its liquidity and the swap transactions it enters into with a financial institution as the counterparty. The Bank maintains cash and cash equivalents, investments, and certain other financial instruments with various major financial institutions, performs periodic evaluations of the relative credit standing of these financial institutions and limits the

amount of credit exposure with any one institution. All of its swaps are with five counterparties, two of which are backed by the federal government of Mexico. The other three are commercial financial institutions rated A1/A+, A2/A and A3/A by two nationally-recognized rating agencies. NADB signs an International Swap and Derivatives Association (ISDA) agreement with appropriate collateral support provisions with the commercial banks with which it enters into swap transactions.

### Liquidity Risk

Liquidity risk arises from a financial institution's inability to meet its contractual obligations in a timely manner without adversely affecting daily operations or the financial condition of the institution. NADB has established liquidity and investment policies to mitigate this risk. Under these policies, NADB maintains a portfolio of liquid investments to ensure that it can meet its financial obligations at all times, even under conditions of constrained market access, as well as have sufficient cash flows to cover its operational needs in the normal course of business.

### Market Risk

The Bank is exposed to market risks as a result of general market movements, mainly through changes in interest and exchange rates affecting earnings on its loan and investment portfolios and the cost of its external borrowings. These risks are mitigated through the Bank's asset and liability management program and its hedging activities.

***Interest Rate Risk:*** There are three potential sources of interest rate risk for the Bank: (i) financial margin volatility from a mismatch in timing on the reset periods to maturity between assets and liabilities; (ii) changes in the market value of investments and redemption of investments to fund loans; and (iii) cost of external borrowings in loan pricing due to decrease in market interest during the term of borrowed funds.

To mitigate the volatility of the financial margin and minimize a repricing mismatch, the Bank uses interest rate swaps to hedge asset and liability positions. Most of the Bank's fixed-rate borrowings have been swapped to a floating interest rate. Fixed-rate loans made with the proceeds of the swapped debt are in turn swapped to a floating rate.

To minimize the risk related to investments, the Bank controls the average duration of its portfolio. To maintain adequate liquidity and protect the Bank's portfolio from significant losses caused by interest rate movements, the average duration of the portfolio may not exceed four years. The Bank structures its investment portfolio so that its investment securities mature concurrent with anticipated cash flow requirements, with additional consideration for unanticipated cash demands.

***Exchange Rate Risk:*** The Bank is exposed to exchange rate risk as a result of its dual-currency lending operations. To minimize exchange rate risk, NADB matches its lending operations to the local currency of the borrower. For U.S. borrowers, loans are available in U.S. dollars. For Mexican borrowers, loans are available in Mexican pesos, as well as in U.S. dollars if the project generates sufficient revenue in U.S. dollars to service the debt. For financing extended in pesos, a currency hedge must be established unless the source of funding for the loan is also in pesos.

COFIDAN, a non-regulated, multi-purpose financial institution established in Mexico to channel NADB loans to state and local public entities in that country, is wholly-owned by the Bank, and its accounts are consolidated with those of the Bank for financial reporting purposes. Since COFIDAN is located in Mexico, it operates primarily using Mexican pesos. Accordingly, the Bank is exposed to some exchange rate risk in the translation of COFIDAN's assets and liabilities into U.S. dollars using the exchange rate in effect at the end of the relevant financial reporting period (revenue and expenses are translated using average exchange rates for the period). The resulting cumulative translation adjustment is included in NADB's accumulated other comprehensive income. Because of the small asset size, such adjustments have not been material and are not expected to be in the future.

### Operational Risk

Operational risk is the potential loss arising from external events or from internal activities due to inadequate or failed processes, a breakdown in systems or human error. Operational risk also includes fraud and failures in the execution of legal, fiduciary and agency responsibilities. These risks stem from the manner in which the Bank is operated, as opposed to the risk arising from its financial transactions.

NADB manages its operational risk through a system of internal controls based on established policies and procedures for all significant areas of operation, including funds management, disbursements, procurement and financial reporting. This system is strengthened by the Bank's highly qualified personnel who maintain the highest standards of integrity and professionalism in the performance of their duties.

In addition, NADB has internal audit staff to evaluate compliance with bank policies, procedures and processes based on continual risk assessments, with direction from Bank management. The internal audit staff reports directly to Bank management and provides semiannual reports to the Board, which include an assessment of the adequacy and effectiveness of NADB's internal control framework and any key internal audit findings.

To further mitigate this risk and strengthen its internal controls, the Bank engaged a consultant in 2013 to perform a comprehensive operational risk assessment that was completed in July 2014. The key recommendations in the final report included establishing a centralized risk management function, improving loan portfolio management and assessment, separating treasury operations from accounting, implementing software to capture and monitor the Bank's risk environment, and enhancing internal audit work. The first recommendation was implemented in November 2014 with the creation of a risk management area and the hiring of an experienced risk manager.

## Basis of Reporting & Critical Accounting Policies

The Bank's consolidated financial statements are prepared in accordance with generally accepted accounting principles (GAAP) in the United States, and are consistent with that of an international organization. The notes to the financial statements contain a summary of NADB's significant accounting policies, including a discussion of recently issued rules and regulations. Certain of these policies are considered to be critical to the portrayal of the Bank's financial condition, because they require NADB management to make difficult, complex or subjective judgments, or relate to matters that are inherently uncertain. These policies include (i) the use of fair value accounting and (ii) the determination of the level of loss allowances and reserves in the loan portfolio.

***Fair Value Accounting:*** The Bank uses fair value measurements to account for the value of its cross-currency interest rate swaps, interest rate swaps, and available-for-sale debt securities. Where possible, fair value is determined by reference to quoted market prices. If quoted market prices are unavailable, then fair value is based on pricing and discounted cash flow models. The selection of data included in pricing and cash flow models involves a significant degree of judgment, and changes in the assumptions and measurements underlying this data could have a substantial impact on the amounts the Bank reports as assets and liabilities, as well as the related unrealized gains and losses reported on its income statement. The Bank believes that its estimates of fair value are reasonable in light of its established processes for obtaining data for use in its models; the periodic evaluation, review and validation of its models; and the consistent application of this approach from period to period. Additional information about this policy can be found in Notes 2 and 11 to the consolidated financial statements.

***Loan Loss Allowances:*** The determination of the allowance for loan losses is based on management's current judgments about the credit quality of the Bank's loan portfolio, and the allowance is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. Determining the appropriate allowance for loan losses involves significant judgment about when a loss has been incurred and the amount of that loss. Actual losses may differ from expected losses due to unforeseen changes in a variety of factors that affect borrowers' creditworthiness and the accuracy of the Bank's allocated allowance. Additional information about this policy can be found in Notes 2 and 4 to the consolidated financial statements.

## External Auditors

The accounts of the Bank are audited annually by independent external auditors with established international experience chosen by the Board on the basis of a proposal by Bank management. In accordance with the policies and principles established by the Board, the external auditors are selected through a competitive process, are appointed for terms of up to five years, and are engaged on an annual basis. Having completed a five-year term as the Bank's external auditors in 2011, Ernst & Young LLP (E&Y) won the bid in 2012 and was appointed by the Board as the Bank's external auditors for a second five-year term that will end in 2016. The Bank renewed its contract with E&Y to carry out the annual audit of its accounts for fiscal year 2014.

# Consolidated Financial Statements and Supplemental Information

North American Development Bank
Years Ended December 31, 2014 and 2013
With Report of Independent Auditors

North American Development Bank

# Report of Independent Auditors

ERNST & YOUNG

The Board of Directors
North American Development Bank

We have audited the accompanying consolidated financial statements of North American Development Bank (the Bank), which comprise the consolidated balance sheets as of December 31, 2014 and 2013, and the related consolidated statements of income and comprehensive income, changes in equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

## Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

## Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

## Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of North American Development Bank at December 31, 2014 and 2013, and the consolidated results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

## Supplementary Information

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplemental information is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to

the auditing procedures applied in the audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

**Ernst & Young, LLP**

San Antonio, Texas
March 31, 2015

North American Development Bank

# Consolidated Balance Sheets

| | December 31 2014 | December 31 2013 |
|---|---|---|
| **Assets** | | |
| Cash and cash equivalents: | | |
| Held at other financial institutions in demand deposit accounts | **$ 1,836,490** | $ 76,348 |
| Held at other financial institutions in interest-bearing accounts | **52,919,581** | 39,527,978 |
| Repurchase agreements | **32,900,000** | 21,000,000 |
| | **87,656,071** | 60,604,326 |
| Held-to-maturity investment securities, at amortized cost | **53,664,254** | 53,619,703 |
| Available-for-sale investment securities, at fair value | **304,203,394** | 435,095,011 |
| Loans outstanding | **1,186,205,931** | 1,012,367,164 |
| Allowance for loan losses | **(11,378,816)** | (12,917,307) |
| Unamortized loan fees | **(8,535,936)** | (3,411,490) |
| Foreign currency exchange rate adjustment | **(32,890,748)** | (16,054,882) |
| Hedged items, at fair value | **1,698,406** | (17,343,992) |
| Net loans outstanding | **1,135,098,837** | 962,639,493 |
| Interest receivable | **10,458,143** | 10,331,837 |
| Grant and other receivable | **1,631,316** | 419,481 |
| Furniture, equipment and leasehold improvements, net | **177,321** | 192,950 |
| Other assets | **43,692,549** | 55,079,144 |
| Total assets | **$ 1,636,581,885** | $ 1,577,981,945 |
| **Liabilities and equity** | | |
| Liabilities: | | |
| Accounts payable | **$ 1,066,206** | $ 993,536 |
| Accrued liabilities | **292,225** | 322,356 |
| Accrued interest payable | **8,394,741** | 8,343,188 |
| Undisbursed grant funds | **1,000** | 1,005 |
| Other liabilities | **20,426,135** | 37,650,115 |
| Short-term debt | **2,631,000** | – |
| Long-term debt, net of discount | **1,052,838,328** | 1,041,314,034 |
| Hedged items, at fair value | **5,047,280** | (34,189,989) |
| Net long-term debt | **1,057,885,608** | 1,007,124,045 |
| Total liabilities | **1,090,696,915** | 1,054,434,245 |
| Equity: | | |
| Paid-in capital | **405,000,000** | 405,000,000 |
| General Reserve: | | |
| Allocated paid-in capital | **4,337,076** | 5,773,589 |
| Retained earnings: | | |
| Designated | **17,719,949** | 19,663,688 |
| Reserved | **94,623,755** | 85,140,670 |
| Undesignated | **24,392,203** | 16,013,735 |
| Accumulated other comprehensive loss | **(194,018)** | (8,050,355) |
| Non-controlling interest | **6,005** | 6,373 |
| Total equity | **545,884,970** | 523,547,700 |
| Total liabilities and equity | **$ 1,636,581,885** | $ 1,577,981,945 |

*The accompanying notes are an integral part of these consolidated financial statements.*

North American Development Bank

# Consolidated Statements of Income

| | Year Ended December 31 2014 | 2013 |
|---|---|---|
| Income: | | |
| Interest: | | |
| Investment income | $ **5,224,734** | $ 4,395,364 |
| Loan income | **38,528,324** | 35,205,952 |
| Gain (loss) on sales of available-for-sale investment securities, net | **188,097** | (8,011) |
| Fee income | **17,257** | 46,261 |
| Other | **1,038,329** | 100 |
| Total revenues | **44,996,741** | 39,639,666 |
| Operating expenses: | | |
| Personnel | **4,877,951** | 5,193,127 |
| Consultants and contractors | **2,380,353** | 2,346,345 |
| General and administrative | **1,070,094** | 1,049,866 |
| Operational travel | **238,823** | 281,591 |
| Depreciation | **49,738** | 35,480 |
| Provision for loan losses | **2,199,499** | 10,544,119 |
| Other | **2,336,949** | 926,792 |
| U.S. Domestic Program | **301,055** | 286,147 |
| Total operating expenses | **13,454,462** | 20,663,467 |
| Interest expense | **13,547,601** | 10,838,179 |
| Income before program activities | **17,994,678** | 8,138,020 |
| Program activities: | | |
| U.S. Environmental Protection Agency (EPA) grant income | **1,041,909** | 1,207,801 |
| EPA grant administration expense | **(1,041,909)** | (1,207,801) |
| Technical Assistance Program expense | **(759,069)** | (689,865) |
| Community Assistance Program expense | **(796,259)** | – |
| Water Conservation Investment Fund expense | **(521,904)** | (455,025) |
| Net program expenses | **(2,077,232)** | (1,144,890) |
| Income before non-controlling interest | **15,917,446** | 6,993,130 |
| Net loss attributable to non-controlling interest | **(368)** | (161) |
| Net income attributable to NADB | $ **15,917,814** | $ 6,993,291 |

*The accompanying notes are an integral part of these consolidated financial statements.*

North American Development Bank

# Consolidated Statements of Comprehensive Income

| | Year Ended December 31 | |
|---|---|---|
| | 2014 | 2013 |
| Net income | $ **15,917,814** | $ 6,993,291 |
| Other comprehensive income (loss): | | |
| Available-for-sale investment securities: | | |
| Change in unrealized gains (losses) during the period, net | **918,065** | (1,164,800) |
| Reclassification adjustment for net (gains) losses included in net income | **(188,097)** | 8,011 |
| Total unrealized gain (loss) on available-for-sale investment securities | **729,968** | (1,156,789) |
| Foreign currency translation adjustment | **47,575** | (41,184) |
| Unrealized gains (losses) on hedging activities: | | |
| Foreign currency translation adjustment, net | **(16,357,061)** | (5,532) |
| Fair value of cross-currency interest rate swaps, net | **23,435,855** | (9,211,861) |
| Total unrealized gain (loss) on hedging activities | **7,078,794** | (9,217,393) |
| Total other comprehensive gain (loss) | **7,856,337** | (10,415,366) |
| Total comprehensive income (loss) | $ **23,774,151** | $ (3,422,075) |

*The accompanying notes are an integral part of these consolidated financial statements.*

North American Development Bank

# Consolidated Statement of Changes in Equity

| | Paid-in Capital | General Reserve: Allocated Paid-in Capital | General Reserve: Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Non-controlling Interest | Total Equity |
|---|---|---|---|---|---|---|
| Beginning balance, January 1, 2013 | $ 405,000,000 | $ 6,602,838 | $ 113,824,802 | $ 2,365,011 | $ 6,534 | $ 527,799,185 |
| Transfer to Targeted Grant Program of the U.S. Domestic Program | – | (829,249) | – | – | – | (829,249) |
| Net income | – | – | 6,993,291 | – | – | 6,993,291 |
| Other comprehensive loss | – | – | – | (10,415,366) | – | (10,415,366) |
| Non-controlling interest | – | – | – | – | (161) | (161) |
| Ending balance, December 31, 2013 | 405,000,000 | 5,773,589 | 120,818,093 | (8,050,355) | 6,373 | 523,547,700 |
| Transfer to Targeted Grant Program of the U.S. Domestic Program | – | **(1,436,513)** | – | – | – | **(1,436,513)** |
| Net income | – | – | **15,917,814** | – | – | **15,917,814** |
| Other comprehensive income | – | – | – | **7,856,337** | – | **7,856,337** |
| Non-controlling interest | – | – | – | – | **(368)** | **(368)** |
| Ending balance, December 31, 2014 | **$ 405,000,000** | **$ 4,337,076** | **$ 136,735,907** | **$ (194,018)** | **$ 6,005** | **$ 545,884,970** |

*The accompanying notes are an integral part of these consolidated financial statements.*

North American Development Bank

# Consolidated Statements of Cash Flows

| | Year Ended December 31 2014 | Year Ended December 31 2013 |
|---|---|---|
| **Operating activities** | | |
| Net income | $ **15,917,814** | $ 6,993,291 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation | **49,738** | 35,480 |
| Amortization of net premium on investments | **2,582,651** | 1,980,067 |
| Change in fair value of swaps and other non-cash items | **41,396,025** | (26,463,294) |
| Non-controlling interest | **(368)** | (161) |
| (Gain) loss on sales of available-for-sale investment securities, net | **(188,097)** | 8,011 |
| Provision for loan losses | **2,199,499** | 10,544,119 |
| Change in other assets and liabilities: | | |
| Increase in interest receivable | **(126,306)** | (1,816,222) |
| (Increase) decrease in receivable and other assets | **1,425,083** | (7,605,846) |
| Increase (decrease) in accounts payable | **72,670** | (75,706) |
| Increase (decrease) in accrued liabilities | **(30,131)** | 84,747 |
| Increase in accrued interest payable | **51,553** | 1,678,491 |
| Net cash provided by (used in) operating activities | **63,350,131** | (14,637,023) |
| **Lending, investing, and development activities** | | |
| Capital expenditures | **(34,109)** | (93,406) |
| Loan principal repayments | **76,585,766** | 74,084,868 |
| Loan disbursements | **(254,162,523)** | (214,964,344) |
| Purchase of held-to-maturity investments | **(3,224,685)** | (1,150,000) |
| Purchase of available-for-sale investments | **(295,316,846)** | (558,724,883) |
| Proceeds from maturities of held-to-maturity investments | **3,203,000** | 1,145,000 |
| Proceeds from sales and maturities of available-for-sale investments | **424,521,011** | 393,086,910 |
| Net cash used in lending, investing, and development activities | **(48,428,386)** | (306,615,855) |
| **Financing activities** | | |
| Proceeds from other borrowings | **13,566,518** | 16,386,468 |
| Proceeds from note issuance | **–** | 299,409,000 |
| Grant funds from the Environmental Protection Agency (EPA) | **15,672,030** | 18,976,292 |
| Grant disbursements – EPA | **(15,672,035)** | (18,976,292) |
| Grant activity – U.S. Domestic Program | **(1,436,513)** | (829,249) |
| Net cash provided by financing activities | **12,130,000** | 314,966,219 |
| Net increase (decrease) in cash and cash equivalents | **27,051,745** | (6,286,659) |
| Cash and cash equivalents at January 1, 2014 and 2013 | **60,604,326** | 66,890,985 |
| Cash and cash equivalents at December 31, 2014 and 2013 | $ **87,656,071** | $ 60,604,326 |
| **Supplemental cash information** | | |
| Cash paid during the year for interest | $ **30,266,987** | $ 23,055,486 |
| **Significant noncash transactions** | | |
| Foreign currency translation adjustment | $ **(16,357,061)** | $ (5,532) |
| Change in fair value of cross-currency interest rate swaps, net | $ **23,435,855** | $ (9,211,861) |
| Change in fair value of available-for-sale investments, net | $ **729,968** | $ (1,156,789) |

*The accompanying notes are an integral part of these consolidated financial statements.*

North American Development Bank

# Notes to Consolidated Financial Statements

December 31, 2014

## 1. Organization and Purpose

The North American Development Bank (NADB or the Bank) was established by an agreement between the governments of the United States of America (the United States or U.S.) and the United Mexican States (Mexico) that was signed by their respective Presidents on November 16 and 18, 1993 (the Charter). The Bank was created to finance environmental infrastructure projects in the U.S.-Mexico border region (the International Program) and community adjustment and investment projects throughout the U.S. and Mexico in support of the purposes of the North American Free Trade Agreement (NAFTA) (the Domestic Programs). On March 16, 1994, the President of the United States issued an Executive Order designating the Bank an international organization under the International Organization Immunities Act.

The Bank began its operations on November 10, 1994, with initial capital subscriptions by the United States and Mexico. The Bank is governed by a Board of Directors appointed by the two countries. The operations of the Bank are subject to certain limitations outlined in the Charter, as amended on August 6, 2004. The geographic jurisdiction of the International Program is within 100 kilometers north of the U.S.-Mexico border and within 300 kilometers south of the border. The Bank is located in San Antonio, Texas.

Under its International Program, the Bank provides loan and grant financing and technical assistance for environmental infrastructure projects certified by the Border Environment Cooperation Commission (BECC), as appropriate, and administers grant funding provided by other entities. Under the Domestic Programs, the Bank contributed funds from its equity to establish the program of each country, and continues to administer the funds of the U.S. Domestic Program (see Note 8).

On June 2, 1998, the Board of Directors adopted a resolution authorizing the Bank to establish a limited-purpose financial institution (*Sociedad Financiera de Objeto Limitado,* SOFOL) for the purpose of facilitating Bank lending to the Mexican public sector. In January 1999, the Corporación Financiera de América del Norte, S.A. de C.V. SOFOL (COFIDAN) began operations in Mexico City and, in October 2006, COFIDAN was converted from a SOFOL to a non-regulated, multipurpose financial institution (SOFOM, E.N.R.), and its name was modified to Corporación Financiera de América del Norte, S.A. de C.V. SOFOM E.N.R. As of December 31, 2014, COFIDAN is 99.90% owned by the Bank and 0.10% owned by the Mexican government. The accounts of COFIDAN are consolidated with the Bank, and all material intercompany accounts and transactions are eliminated in consolidation. The non-controlling interest reflected in the consolidated balance sheets and consolidated statements of income represents the ownership of the Mexican government through the Ministry of Finance and Public Credit (SHCP).

## 2. Summary of Significant Accounting Policies

### Basis of Presentation and Use of Estimates in Financial Statements

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) and are presented in a manner consistent with that of an international organization. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. These estimates include investments, allowance for loan losses, the fair value of derivative instruments and other real estate owned included in other assets, and the fair value of derivative instruments included in other liabilities and in long-term debt. Actual results could differ from those estimates.

### Principles of Consolidation

The consolidated financial statements include the accounts of the Bank and its subsidiary, COFIDAN. All significant intercompany accounts and transactions have been eliminated in consolidation.

## 2. Summary of Significant Accounting Policies (continued)

### Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash deposits with other financial institutions and repurchase agreements.

### Repurchase Agreements

The Bank has entered into agreements with two major financial institutions to purchase various U.S. government and federally sponsored agency securities under an agreement to resell. The purchase and resale of these securities occur daily, and the obligation to repurchase is backed by the assets of the related financial institutions. The underlying securities related to the repurchase transaction are held in the possession of the respective financial institutions.

### Investment Securities

The Bank's investments are classified into the following categories:

*Held-to-maturity* – This category is composed of those debt securities for which the Bank has the positive intent and ability to hold to maturity. These securities are carried at amortized cost.

*Trading* – This category is composed of debt securities that are bought and held for resale in the near term. These securities are carried at fair value, and changes in market value are recognized in the consolidated statements of income.

*Available-for-sale* – This category is composed of debt securities that are not classified as either trading or held-to-maturity securities. These securities are carried at fair value, with unrealized holding gains and losses excluded from earnings and reported as a net amount in a separate component of comprehensive income or loss until realized.

The accretion of discounts and the amortization of premiums are computed using the interest method. Realized gains and losses are determined using the specific identification method. Investments in a loss position are reviewed in order to determine whether the unrealized loss, which is considered an impairment, is temporary or other-than-temporary. In the event of other-than-temporary impairment, the cost basis of the investment would be written down to its fair value, and the credit component of the loss would be included in current earnings. The Bank had no securities classified as other-than-temporarily impaired as of December 31, 2014 and 2013.

### Taxation

As an international organization, the Bank is exempt from all federal, state, and local taxation to the extent implemented by law under the U.S. International Organizations Immunities Act of 1945.

### Furniture, Equipment, and Leasehold Improvements

Furniture and equipment are recorded at cost and depreciated over their estimated useful lives using the straight-line method. The estimated useful life is three years for computers and five years for furniture and equipment. Leasehold improvements are recorded at cost and amortized over five years, or the life of the lease, whichever is less.

### General Reserve

The Board of Directors defines the General Reserve as retained earnings plus allocated paid-in capital for the U.S. Domestic Program, as described in Note 8. Retained earnings are classified as either designated for a specific program, reserved, or undesignated.

## 2. Summary of Significant Accounting Policies (continued)

Undesignated retained earnings in excess of one percent (1.0%) of total assets of the International Program are used to fund four reserves in the following order of priority:

*Debt Service Reserve* – This reserve is maintained in an amount equal to 12 months of interest due on the Bank's outstanding debt at each fiscal year-end.

*Operating Expenses Reserve* – This reserve is maintained in an amount equal to 12 months of the operating budget expenses at each fiscal year-end.

*Special Reserve* – This reserve is maintained in an amount equal to the sum of: 1% of undisbursed loan commitments, 3% of the outstanding balance of disbursed loans and 3% of the outstanding balance of guaranties, less the general allowance for loan losses, with a targeted minimum of $30 million. Amounts in the Special Reserve are to be used to pay costs associated with the enforcement of the Bank's rights under its loan and guaranty agreements and to offset losses on any loan or guaranty.

*Capital Preservation Reserve* – This reserve is intended to maintain the value of the paid-in capital in real terms and is indexed to the U.S. annual inflation rate.

### Loans and Allowance for Loan Losses

Loans are reported at the principal amount, net of allowance for loan losses, unamortized loan fees, foreign currency exchange rate adjustment, and fair value of hedged items. Interest income on loans is recognized in the period earned. Net loan commitment and origination fees are deferred and amortized over the life of the loan as an adjustment to loan interest income.

Loans that are past due 90 days or more as to principal or interest, or where reasonable doubts exist as to timely collection, including loans that are individually identified as being impaired, are generally classified as nonperforming loans unless well secured and in the process of collection.

Loans are generally placed in nonaccrual status when principal or interest is delinquent for 180 days (unless adequately secured and in the process of collection) or circumstances indicate that the full collection of principal and interest is in doubt. When a loan is placed in nonaccrual status, accrued interest deemed uncollectible is either reversed (if current-year interest) or charged against current-year interest (if prior-year interest).

Payments received on nonaccrual loans are generally applied to the recorded investment in the loan asset. If collection of the recorded investment in the loan is fully expected and the loan does not have a remaining unrecovered prior charge-off associated with it, payments are recognized as interest income. Nonaccrual loans may be returned to accrual status when contractual principal and interest are current, prior charge-offs have been recovered, the ability of the borrower to fulfill the contractual repayment terms is fully expected, and the loan is not classified as "doubtful" or "loss." If previously unrecognized interest income exists upon reinstatement of a nonaccrual loan to accrual status, interest income will only be recognized upon receipt of cash payments applied to the loan.

In cases where a borrower experiences financial difficulties and the Bank makes certain monetary concessions to the borrower through modifications of the contractual terms of the loan, the loan is classified as a restructured troubled loan. If the borrower's ability to meet the revised payment schedule is uncertain, the loan is classified as a nonaccrual loan.

The allowance for loan losses is a valuation account used to reasonably estimate loan losses incurred as of the financial statement date. Determining the appropriate allowance for loan losses involves significant judgment about when a loss has been incurred and

## 2. Summary of Significant Accounting Policies (continued)

the amount of that loss. The determination of the allowance for loan losses is based on management's current judgment about the credit quality of the loan portfolio. A specific allowance is established for impaired loans that exhibit a distinct possibility that the Bank may sustain some loss. Impairment of these loans is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate or the fair value of the collateral, if the loan is collateral-dependent. In 2013, under the International Program, a general allowance for loans to private-sector borrowers was established based on statistical cumulative default and recovery rates for project finance loans.

The allowance for loan losses is maintained at a level considered adequate by management to provide for probable and estimable losses inherent in the loan portfolio. The allowance is increased through provision for loan losses and is decreased through reversals of provision for loan losses and loan charge-offs. Upon final settlement of impaired loans, any remaining loss is charged off immediately.

### Credit Quality

The Bank monitors the credit quality of its loan portfolio on an ongoing basis by tracking certain credit quality indicators related to the borrower's: (i) payment history, (ii) strength of management, (iii) financial performance, (iv) appropriateness and effectiveness of project technology, and (v) loan covenant compliance, as well as (vi) general economic conditions in the borrower's geographic location, (vii) the legal and regulatory environment, and (viii) the effects, if any, of the current political environment. Based on this evaluation, each loan is assigned to one of the following risk categories:

*Pass* – The loan is not considered a greater than normal credit risk. The Bank believes the borrower has the ability to meet its obligations; therefore, the Bank anticipates insignificant uncollectible amounts.

*Special Mention* – The loan has exhibited potential weaknesses that deserve the Bank's close attention. If left uncorrected, these potential weaknesses may result in noticeable deterioration of the repayment prospects for the asset or of the borrower's credit position.

*Substandard* – The loan is inadequately protected by the current financial condition and paying capacity of the borrower or by any collateral pledged. The loan has a well-defined weakness or weaknesses that may jeopardize the collection of the debt pursuant to the contractual principal and interest terms. Such risk is characterized by the distinct possibility that the Bank may sustain some loss if the deficiencies are not corrected.

*Doubtful* – In addition to the risk characteristics described in the substandard category, the loan exhibits conditions and values that make collection or liquidation in full highly improbable. Loans in this risk category are closely managed to determine the highest recovery alternatives.

### Program Activities

Program income represents reimbursed administrative expenses associated with the U.S. Environmental Protection Agency (EPA) grant activities. Such amounts are earned and recognized as program income in the accompanying consolidated statements of income as the associated expenses are incurred.

Program expenses include grant disbursements made by the Bank and administrative costs associated with EPA grant activities. Grants are recognized at the date the Bank becomes obligated under the terms of the grant agreements and associated costs are recognized as incurred. EPA and U.S. Domestic Program grant receipts and disbursements reflected in the consolidated statements of cash flows are not reflected in the accompanying consolidated statements of income, as these grants are approved and funded by the respective entities noted above. The Bank's role is to administer these funds.

## 2. Summary of Significant Accounting Policies (continued)

### Foreign Currency

COFIDAN is located in Mexico and operates primarily using the local functional currency. Accordingly, all assets and liabilities of COFIDAN are translated using the exchange rate in effect at the end of the period, and revenue and costs are translated using average exchange rates for the period. The resulting cumulative translation adjustment is included in accumulated other comprehensive income.

The lending activities of the Bank include making loans that are denominated in Mexican pesos. For such loans, the Bank enters into cross-currency interest rate swaps that mitigate its exposure to fluctuations in foreign currency exchange rates and interest rates. As of December 31, 2014, the Bank had entered into swap counterparty agreements with Fondo de Apoyo a Estados y Municipios (FOAEM), a fund owned by the government of Mexico and administered by the federally run development bank, Banco Nacional de Obras y Servicios Publicos, S.N.C. (Banobras); directly with Banobras outside the FOAEM arrangement; and with three other financial institutions. The foreign currency translation adjustment on loans denominated in Mexican pesos as of December 31, 2014 and 2013 was $(32,890,748) and $(16,054,882), respectively. Changes in the foreign currency translation adjustment are reported through other comprehensive income.

All swaps relating to the lending activities of the Bank have been designated as cash flow or fair value hedges and are recognized in the accompanying consolidated balance sheets at their fair value. Changes in the fair value of the cash flow hedges are reported in other comprehensive income and are reclassified to earnings at the time of the hedged loan repayment. Changes in the fair value of the fair value hedges are reported in other income or expense. The fair value of these hedges was reported in the accompanying consolidated balance sheets at December 31, 2014 as other assets of $36,938,315 and other liabilities of $7,039,801 and at December 31, 2013 as other assets of $30,093,188 and other liabilities of $6,251,708.

The Bank discontinues hedge accounting prospectively if it determines that the derivative is no longer highly effective in offsetting changes in the fair value or cash flows of the hedged item, or if it is no longer probable that the hedged loan repayment will occur. If hedge accounting is discontinued because the hedge ceases to be effective, the Bank will continue to record the swap at fair value with changes in value reflected in earnings, and any fair value adjustments included in other comprehensive income will be recognized in the consolidated statements of income over the remaining life of the loan. If it is probable that the hedged loan repayments will not occur, gains and losses accumulated in other comprehensive income (loss) are recognized immediately in earnings.

Derivatives executed with certain counterparties are subject to a master netting arrangement. Fair-value amounts recognized for derivatives and for the right or obligation to reclaim or return cash collateral are offset for financial reporting purposes. Additional information on the amounts subject to master netting arrangements and collateral is provided in Note 5.

### Fair Value

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Bank carries cross-currency interest rate swaps, interest rate swaps, hedged items, and available-for-sale debt securities at fair value. To determine the fair market value of its financial instruments, the Bank uses the fair value hierarchy, which is based on three levels of inputs as follows:

*Level 1* – Quoted prices in active markets for identical assets or liabilities, which the reporting entity has the ability to access at the measurement date. This category generally includes U.S. government securities.

*Level 2* – Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities, quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially

## 2. Summary of Significant Accounting Policies (continued)

the full term of the assets or liabilities. This category generally includes U.S. agency securities, corporate debt securities, other fixed-income securities, United Mexican States (UMS) securities, and mortgage-backed debt securities.

*Level 3* – Unobservable inputs that are supported by little or no market activity and that are significant in determining the fair value of the assets or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category includes cross-currency interest rate swaps, interest rate swaps, the fair value of hedged items, and other real estate owned where independent pricing information is not available for a significant portion of the underlying assets. For these consolidated financial statements, the Bank also obtains dealer quotations for comparative purposes to assess the reasonableness of the pricing models.

Additional information on the fair value of the financial instruments of the Bank is provided in Note 11.

### Accumulated Other Comprehensive Income

The components of other comprehensive income are reported in the accompanying consolidated statements of comprehensive income for all periods presented and in Note 7.

### Other Income and Other Expenses

Other income and other expenses consist primarily of net foreign exchange gains (losses) and net gains (losses) from swaps.

### Reclassifications

Certain amounts in the prior year consolidated financial statements have been reclassified to conform to the current year consolidated financial statement presentation.

## 3. Investments

All investments held by the Bank are classified as either held-to-maturity or available-for-sale securities. The following schedule summarizes investments as of December 31, 2014 and 2013.

| | | Gross Unrealized | | |
|---|---|---|---|---|
| | Amortized Cost | Gains | Losses | Fair Value |
| **December 31, 2014** | | | | |
| Held-to-maturity: | | | | |
| U.S. agency securities | **$ 3,799,685** | **$ 489** | **$ (4,634)** | **$ 3,795,540** |
| Mexican government securities (UMS) | **49,864,569** | **5,260,431** | **–** | **55,125,000** |
| Total held-to-maturity investment securities | **53,664,254** | **5,260,920** | **(4,634)** | **58,920,540** |
| Available-for-sale: | | | | |
| U.S. government securities | **106,194,365** | **49,534** | **(74,585)** | **106,169,314** |
| U.S. agency securities | **68,850,600** | **66,249** | **(89,660)** | **68,827,189** |
| Corporate debt securities | **83,946,144** | **110,439** | **(91,205)** | **83,965,378** |
| Other fixed-income securities | **30,131,807** | **54,159** | **(31,408)** | **30,154,558** |
| Mexican government securities (UMS) | **15,099,181** | **14,824** | **(50,263)** | **15,063,742** |
| Mortgage-backed securities | **22,588** | **625** | **–** | **23,213** |
| Total available-for-sale investment securities | **304,244,685** | **295,830** | **(337,121)** | **304,203,394** |
| Total investment securities | **$ 357,908,939** | **$ 5,556,750** | **$ (341,755)** | **$ 363,123,934** |
| **December 31, 2013** | | | | |
| Held-to-maturity: | | | | |
| U.S. agency securities | $ 3,778,000 | $ 2,033 | $ (2,430) | $ 3,777,603 |
| Mexican government securities (UMS) | 49,841,703 | 5,558,297 | – | 55,400,000 |
| Total held-to-maturity investment securities | 53,619,703 | 5,560,330 | (2,430) | 59,177,603 |
| Available-for-sale: | | | | |
| U.S. government securities | 176,847,338 | 68,756 | (110,413) | 176,805,681 |
| U.S. agency securities | 92,580,053 | 3,259 | (301,900) | 92,281,412 |
| Corporate debt securities | 105,040,656 | 54,732 | (494,020) | 104,601,368 |
| Other fixed-income securities | 42,907,758 | 92,294 | (44,848) | 42,955,204 |
| Mexican government securities (UMS) | 18,415,253 | – | (42,753) | 18,372,500 |
| Mortgage-backed securities | 75,212 | 3,634 | – | 78,846 |
| Total available-for-sale investment securities | 435,866,270 | 222,675 | (993,934) | 435,095,011 |
| Total investment securities | $ 489,485,973 | $ 5,783,005 | $ (996,364) | $ 494,272,614 |

## 3. Investments (continued)

The following schedule summarizes unrealized losses and the fair value of investments aggregated by category and the length of time individual securities have been in a continuous unrealized loss position as of December 31, 2014 and 2013.

| | Less Than 12 Months | | 12 Months or More | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses | Fair Value | Unrealized Losses |
| **December 31, 2014** | | | | | | |
| Held-to-maturity: | | | | | | |
| U.S. agency securities | **$ 3,220,051** | **$ 4,634** | **$ –** | **$ –** | **$ 3,220,051** | **$ 4,634** |
| Mexican government securities (UMS) | **–** | **–** | **–** | **–** | **–** | **–** |
| Total held-to-maturity investment securities | **3,220,051** | **4,634** | **–** | **–** | **3,220,051** | **4,634** |
| Available-for-sale: | | | | | | |
| U.S. government securities | **67,687,951** | **74,585** | **–** | **–** | **67,687,951** | **74,585** |
| U.S. agency securities | **32,392,395** | **89,660** | **–** | **–** | **32,392,395** | **89,660** |
| Corporate debt securities | **35,682,081** | **91,205** | **–** | **–** | **35,682,081** | **91,205** |
| Other fixed-income securities | **6,001,354** | **31,408** | **–** | **–** | **6,001,354** | **31,408** |
| Mexican government securities (UMS) | **11,049,242** | **50,263** | **–** | **–** | **11,049,242** | **50,263** |
| Mortgaged-backed securities | **–** | **–** | **–** | **–** | **–** | **–** |
| Total available-for-sale investment securities | **152,813,023** | **337,121** | **–** | **–** | **152,813,023** | **337,121** |
| Total temporarily impaired securities | **$ 156,033,074** | **$ 341,755** | **$ –** | **$ –** | **$ 156,033,074** | **$ 341,755** |
| **December 31, 2013** | | | | | | |
| Held-to-maturity: | | | | | | |
| U.S. agency securities | $ 1,657,570 | $ 2,430 | $ – | $ – | $ 1,657,570 | $ 2,430 |
| Mexican government securities (UMS) | – | – | – | – | – | – |
| Total held-to-maturity investment securities | 1,657,570 | 2,430 | – | – | 1,657,570 | 2,430 |
| Available-for-sale: | | | | | | |
| U.S. government securities | 101,158,872 | 110,413 | – | – | 101,158,872 | 110,413 |
| U.S. agency securities | 76,008,856 | 301,900 | – | – | 76,008,856 | 301,900 |
| Corporate debt securities | 80,252,396 | 494,020 | – | – | 80,252,396 | 494,020 |
| Other fixed-income securities | 24,365,068 | 44,848 | – | – | 24,365,068 | 44,848 |
| Mexican government securities (UMS) | 18,372,500 | 42,753 | – | – | 18,372,500 | 42,753 |
| Mortgaged-backed securities | – | – | – | – | – | – |
| Total available-for-sale investment securities | 300,157,692 | 993,934 | – | – | 300,157,692 | 993,934 |
| Total temporarily impaired securities | $ 301,815,262 | $ 996,364 | $ – | $ – | $ 301,815,262 | $ 996,364 |

None of the unrealized losses identified in the preceding table are considered to be other-than-temporary since, as of December 31, 2014, the Bank did not have the intent to sell any of these securities and believed that it was more-likely-than-not that the Bank would not be required to sell any such securities before a recovery of cost.

## 3. Investments (continued)

Contractual maturities of investments as of December 31, 2014 and 2013 are summarized in the following tables.

| | Held-to-Maturity Securities | | Available-for-Sale Securities | |
|---|---|---|---|---|
| | Fair Value | Amortized Cost | Fair Value | Amortized Cost |
| **December 31, 2014** | | | | |
| Less than 1 year | **$ –** | **$ –** | **$ 159,765,448** | **$ 159,783,965** |
| 1–5 years | **3,795,540** | **3,799,685** | **144,414,733** | **144,438,132** |
| 5–10 years | **55,125,000** | **49,864,569** | **–** | **–** |
| More than 10 years | **–** | **–** | **–** | **–** |
| Mortgage-backed securities | **–** | **–** | **23,213** | **22,588** |
| | **$ 58,920,540** | **$ 53,664,254** | **$ 304,203,394** | **$ 304,244,685** |
| **December 31, 2013** | | | | |
| Less than 1 year | $ – | $ – | $ 261,396,676 | $ 261,395,009 |
| 1–5 years | 3,777,603 | 3,778,000 | 173,619,489 | 174,396,049 |
| 5–10 years | 55,400,000 | 49,841,703 | – | – |
| More than 10 years | – | – | – | – |
| Mortgage-backed securities | – | – | 78,846 | 75,212 |
| | $ 59,177,603 | $ 53,619,703 | $ 435,095,011 | $ 435,866,270 |

Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

The following table summarizes sale, call, and maturity activity of investment securities for the years ended December 31, 2014 and 2013.

| | Year Ended December 31 | |
|---|---|---|
| | 2014 | 2013 |
| Held-to-maturity investment securities: | | |
| Proceeds from maturities | **$ 3,203,000** | $ 1,145,000 |
| Available-for-sale investment securities: | | |
| Proceeds from sales and maturities | **424,521,011** | 393,086,910 |
| Gross realized gains | **190,182** | 261,809 |
| Gross realized losses | **2,085** | 269,820 |

The following table sets forth the unrealized gains (losses) on securities available-for-sale and the reclassification adjustments required for the years ended December 31, 2014 and 2013.

| | 2014 | 2013 |
|---|---|---|
| Unrealized gains (losses) on investment securities available-for-sale, beginning of year | **$ (771,259)** | $ 385,530 |
| Unrealized gains (losses) on investment securities available-for-sale, arising during the year | **918,065** | (1,164,800) |
| Reclassification adjustments for (gains) losses on investment securities available-for-sale included in net income | **(188,097)** | 8,011 |
| Net unrealized losses on investment securities available-for-sale, end of year | **$ (41,291)** | $ (771,259) |

## 4. Loans

The following schedule summarizes loans outstanding as of December 31, 2014 and 2013.

| | International Program | U.S. Domestic Program | Total |
|---|---|---|---|
| **December 31, 2014** | | | |
| Loan balance | **$ 1,185,514,182** | **$ 691,749** | **$ 1,186,205,931** |
| Allowance for loan losses: | | | |
| General | **(11,355,628)** | **(23,188)** | **(11,378,816)** |
| Specific | **–** | **–** | **–** |
| Unamortized loan fees | **(8,535,936)** | **–** | **(8,535,936)** |
| Foreign currency exchange rate adjustment | **(32,890,748)** | **–** | **(32,890,748)** |
| Fair value of hedged items | **1,698,406** | **–** | **1,698,406** |
| Net loans outstanding | **$ 1,134,430,276** | **$ 668,561** | **$ 1,135,098,837** |
| **December 31, 2013** | | | |
| Loan balance | $ 1,011,211,596 | $ 1,155,568 | $ 1,012,367,164 |
| Allowance for loan losses: | | | |
| General | (9,453,064) | (23,188) | (9,476,252) |
| Specific | (3,441,055) | – | (3,441,055) |
| Unamortized loan fees | (3,411,490) | – | (3,411,490) |
| Foreign currency exchange rate adjustment | (16,054,882) | – | (16,054,882) |
| Fair value of hedged items | (17,343,992) | – | (17,343,992) |
| Net loans outstanding | $ 961,507,113 | $ 1,132,380 | $ 962,639,493 |

At December 31, 2014 and 2013, the International Program had outstanding loan commitments on signed loan agreements totaling $126,985,036 and $238,780,007, respectively. At December 31, 2014 and 2013, the U.S. Domestic Program did not have any outstanding loan commitments on signed loan agreements. The Board has also approved an additional $145,113,514 in loans for the International Program, for which loan agreements are in development.

The Bank under certain circumstances offered below-market-rate loans. As of December 31, 2014 and 2013, the Bank had below-market-rate loans outstanding for the International Program of $46,808,142 and $50,353,220, respectively. At December 31, 2014 and 2013, the U.S. Domestic Program did not have any below-market-rate loans.

## 4. Loans (continued)

The following table presents the loan portfolio by sector as of December 31, 2014 and 2013.

| | December 31 | |
|---|---|---|
| | 2014 | 2013 |
| International Program: | | |
| Air Quality | **$ 136,216,927** | $ 118,618,859 |
| Basic Urban Infrastructure | **23,514,816** | 29,004,705 |
| Clean Energy: | | |
| Solar | **341,536,534** | 267,622,888 |
| Wind | **430,528,983** | 369,929,600 |
| Other | **2,608,099** | 1,136,359 |
| Storm Drainage | **62,862,096** | 66,057,730 |
| Water and Wastewater | **188,246,727** | 158,841,455 |
| Total International Program | **1,185,514,182** | 1,011,211,596 |
| U.S. Domestic Program | **691,749** | 1,155,568 |
| | **$ 1,186,205,931** | $ 1,012,367,164 |

The following table presents the loan portfolio by risk category as of December 31, 2014 and 2013. These risk categories are defined in Note 2, along with additional information on how the Bank evaluates credit quality.

| | December 31 | |
|---|---|---|
| | 2014 | 2013 |
| International Program: | | |
| Pass | **$ 1,182,128,587** | $ 1,004,236,219 |
| Special Mention | **3,385,595** | 3,693,738 |
| Substandard | **–** | – |
| Doubtful | **–** | 3,281,639 |
| Total International Program | **1,185,514,182** | 1,011,211,596 |
| U.S. Domestic Program: | | |
| Pass | **314,541** | 763,578 |
| Special Mention | **377,208** | 391,990 |
| Substandard | **–** | – |
| Doubtful | **–** | – |
| Total U.S. Domestic Program | **691,749** | 1,155,568 |
| | **$ 1,186,205,931** | $ 1,012,367,164 |

The International Program had one nonaccrual loan with an outstanding balance of $3,385,595 as of December 31, 2014 and had two nonaccrual loans with an outstanding balance of $6,975,377 as of December 31, 2013. The average impaired loan balance for the years ended December 31, 2014 and 2013 totaled $4,488,469 and $13,251,894, respectively. No interest income was recognized on the impaired loans for the years ended December 31, 2014 and 2013. In December 2013, the Bank foreclosed on the collateral of a loan under the International Program with an outstanding balance, net of allowance for loan loss, of $7,179,731, and received that amount as partial payment. As of December 31, 2014 and 2013, the Bank had collateral from foreclosed loans reported as other assets of $5,953,307 and $7,833,038, respectively.

## 4. Loans (continued)

Under the International Program, the outstanding balance of loans past due 90 days or more that was still accruing interest was $0 and $77,619 as of December 31, 2014 and 2013, respectively. Under the U.S. Domestic Program, the outstanding balance of loans past due 90 days or more that was still accruing interest was $377,208 and $0 as of December 31, 2014 and 2013, respectively.

An age analysis of past-due loans, including both accruing and non-accruing loans, as of December 31, 2014 and 2013, is shown in the following table.

| | Loans 30–89 Days Past Due | Loans 90 or More Days Past Due | Total Past-due Loans |
|---|---|---|---|
| **December 31, 2014** | | | |
| International Program | **$ –** | **$ 3,385,595** | **$ 3,385,595** |
| U.S. Domestic Program | **–** | **377,208** | **377,208** |
| | **$ –** | **$ 3,762,803** | **$ 3,762,803** |
| **December 31, 2013** | | | |
| International Program | $ – | $ 7,052,996 | $ 7,052,996 |
| U.S. Domestic Program | – | – | – |
| | $ – | $ 7,052,996 | $ 7,052,996 |

The following table summarizes the allowance for loan losses by classification as of December 31, 2014 and 2013.

| | Allowance for Loan Losses | | | |
|---|---|---|---|---|
| | General Allowance | Specific Allowance | Total | Total Loans Outstanding |
| **December 31, 2014** | | | | |
| International Program: | | | | |
| Private: | | | | |
| Construction | **$ 5,528,110** | **$ –** | **$ 5,528,110** | **$ 178,946,567** |
| Operation | **5,827,518** | **–** | **5,827,518** | **595,727,049** |
| Public | **–** | **–** | **–** | **319,768,042** |
| Public-private | **–** | **–** | **–** | **91,072,524** |
| Total International Program | **11,355,628** | **–** | **11,355,628** | **1,185,514,182** |
| U.S. Domestic Program | **23,188** | **–** | **23,188** | **691,749** |
| | **$ 11,378,816** | **$ –** | **$ 11,378,816** | **$ 1,186,205,931** |
| **December 31, 2013** | | | | |
| International Program: | | | | |
| Private: | | | | |
| Construction | $ 4,950,438 | $ – | $ 4,950,438 | $ 166,440,298 |
| Operation | 4,502,626 | 3,441,055 | 7,943,681 | 475,530,189 |
| Public | – | – | – | 345,376,590 |
| Public-private | – | – | – | 23,864,519 |
| Total International Program | 9,453,064 | 3,441,055 | 12,894,119 | 1,011,211,596 |
| U.S. Domestic Program | 23,188 | – | 23,188 | 1,155,568 |
| | $ 9,476,252 | $ 3,441,055 | $ 12,917,307 | $ 1,012,367,164 |

Public-private refers to loans made to private-sector borrowers and backed by public-sector federal tax revenue.

## 4. Loans (continued)

The following schedule summarizes the allowance for loan losses for the years ended December 31, 2014 and 2013.

| | Allowance for Loan Losses | | | | |
|---|---|---|---|---|---|
| | Beginning Balance | Specific | General | Loan (Charge-offs) Recoveries | Ending Balance |
| **December 31, 2014** | | | | | |
| International Program: | | | | | |
| Private: | | | | | |
| Construction | **$ 4,950,438** | **$ –** | **$ 577,672** | **$ –** | **$ 5,528,110** |
| Operation | **7,943,681** | **(11,208)** | **1,324,892** | **(3,429,847)** | **5,827,518** |
| Public | **–** | **308,143** | **–** | **(308,143)** | **–** |
| Public-private | **–** | **–** | **–** | **–** | **–** |
| Total International Program | **12,894,119** | **296,935** | **1,902,564** | **(3,737,990)** | **11,355,628** |
| U.S. Domestic Program | **23,188** | **–** | **–** | **–** | **23,188** |
| | **$ 12,917,307** | **$ 296,935** | **$ 1,902,564** | **$ (3,737,990)** | **$ 11,378,816** |
| **December 31, 2013** | | | | | |
| International Program: | | | | | |
| Private: | | | | | |
| Construction | $ – | $ – | $ 4,950,438 | $ – | $ 4,950,438 |
| Operation | 2,350,000 | 1,091,055 | 4,502,626 | – | 7,943,681 |
| Public | – | – | – | – | – |
| Public-private | – | – | – | – | – |
| Total International Program | 2,350,000 | 1,091,055 | 9,453,064 | – | 12,894,119 |
| U.S. Domestic Program | 23,188 | – | – | – | 23,188 |
| | $ 2,373,188 | $ 1,091,055 | $ 9,453,064 | $ – | $ 12,917,307 |

## 5. Other Assets and Other Liabilities

The following table presents the gross and net balances of other assets and other liabilities, including the result of master netting arrangements for derivatives with certain swap counterparties, at December 31, 2014 and 2013.

| | Gross Amount | Master Netting Arrangements | Net Amount |
|---|---|---|---|
| **December 31, 2014** | | | |
| **Other assets** | | | |
| Cross-currency interest rate swaps | **$ 55,371,929** | **$ (18,433,614)** | **$ 36,938,315** |
| Interest rate swaps | **18,433,614** | **–** | **18,433,614** |
| Collateral from swap counterparty | **(21,900,000)** | **–** | **(21,900,000)** |
| Unamortized debt issuance costs | **4,267,313** | **–** | **4,267,313** |
| Other real estate owned | **5,953,307** | **–** | **5,953,307** |
| Total other assets | **$ 62,126,163** | **$ (18,433,614)** | **$ 43,692,549** |
| **Other liabilities** | | | |
| Interest rate swaps | **$ 20,426,135** | **$ –** | **$ 20,426,135** |
| Total other liabilities | **$ 20,426,135** | **$ –** | **$ 20,426,135** |
| **December 31, 2013** | | | |
| **Other assets** | | | |
| Cross-currency interest rate swaps | $ 20,413,506 | $ (354,448) | $ 20,059,058 |
| Interest rate swaps | 26,962,548 | – | 26,962,548 |
| Collateral from swap counterparty | (4,800,000) | – | (4,800,000) |
| Unamortized debt issuance costs | 5,024,500 | – | 5,024,500 |
| Other real estate owned | 7,833,038 | – | 7,833,038 |
| Total other assets | $ 55,433,592 | $ (354,448) | $ 55,079,144 |
| **Other liabilities** | | | |
| Cross-currency interest rate swaps | $ 7,571,012 | $ (964,396) | $ 6,606,616 |
| Interest rate swaps | 51,236,082 | (472,583) | 50,763,499 |
| Collateral to swap counterparty | (19,720,000) | – | (19,720,000) |
| Total other liabilities | $ 39,087,094 | $ (1,436,979) | $ 37,650,115 |

North American Development Bank

# Notes to Consolidated Financial Statements

## 6. Debt

The following table summarizes the notes payable and other borrowings as of December 31, 2014 and 2013.

| | | | December 31, 2014 | | | |
|---|---|---|---|---|---|---|
| Issue Date | Maturity Date | Fixed Rate | Principal Amount | Unamortized Discount | Fair Value of Hedged Items | Net Debt |
| **Notes payable** | | | | | | |
| Feb. 11, 2010 | Feb. 11, 2020 | 4.375% | $ 250,000,000 | $ (333,500) | $ 18,314,050 | $ 267,980,550 |
| Oct. 26, 2012 | Oct. 26, 2022 | 2.400 | 250,000,000 | (672,472) | (5,714,651) | 243,612,877 |
| Dec. 17, 2012 | Oct. 26, 2022 | 2.400 | 180,000,000 | (2,959,082) | (6,291,382) | 170,749,536 |
| Dec. 17, 2012 | Dec. 17, 2030 | 3.300 | 50,000,000 | – | (1,380,301) | 48,619,699 |
| Oct. 10, 2013 | Oct. 10, 2018 | 2.300 | 300,000,000 | (518,603) | 119,564 | 299,600,961 |
| Total notes payable | | | 1,030,000,000 | (4,483,657) | 5,047,280 | 1,030,563,623 |
| **Other borrowings** | | | | | | |
| Mar. 7, 2013 | Dec. 30, 2015 | 1.900% | 2,631,000 | – | – | 2,631,000 |
| Mar. 7, 2013 | Jun. 30, 2016 | 1.900 | 1,653,972 | – | – | 1,653,972 |
| Aug. 15, 2013 | Jun. 30, 2016 | 1.900 | 977,028 | – | – | 977,028 |
| Aug. 15, 2013 | Dec. 30, 2016 | 1.900 | 2,631,000 | – | – | 2,631,000 |
| Aug. 15, 2013 | Jun. 30, 2017 | 1.900 | 2,631,000 | – | – | 2,631,000 |
| Aug. 15, 2013 | Dec. 30, 2017 | 1.900 | 2,631,000 | – | – | 2,631,000 |
| Aug. 15, 2013 | Jun. 30, 2018 | 1.900 | 2,631,000 | – | – | 2,631,000 |
| Aug. 15, 2013 | Dec. 30, 2018 | 1.900 | 600,467 | – | – | 600,467 |
| Apr. 11, 2014 | Dec. 30, 2018 | 1.900 | 2,030,533 | – | – | 2,030,533 |
| Apr. 11, 2014 | Jun. 30, 2019 | 1.900 | 2,631,000 | – | – | 2,631,000 |
| Apr. 11, 2014 | Dec. 30, 2019 | 1.900 | 2,632,000 | – | – | 2,632,000 |
| Apr. 11, 2014 | Jun. 30, 2020 | 1.900 | 526,785 | – | – | 526,785 |
| Aug. 14, 2014 | Jun. 30, 2020 | 1.900 | 2,105,215 | – | – | 2,105,215 |
| Aug. 14, 2014 | Dec. 30, 2020 | 1.900 | 2,632,000 | – | – | 2,632,000 |
| Aug. 14, 2014 | Jun. 30, 2021 | 1.900 | 1,008,985 | – | – | 1,008,985 |
| Total other borrowings | | | 29,952,985 | – | – | 29,952,985 |
| | | | $ 1,059,952,985 | $ (4,483,657) | $ 5,047,280 | $ 1,060,516,608 |

## 6. Debt (continued)

| | | | December 31, 2013 | | | |
|---|---|---|---|---|---|---|
| Issue Date | Maturity Date | Fixed Rate | Principal Amount | Unamortized Discount | Fair Value of Hedged Items | Net Debt |
| **Notes payable** | | | | | | |
| Feb. 11, 2010 | Feb. 11, 2020 | 4.375% | $ 250,000,000 | $ (398,750) | $ 16,928,418 | $ 266,529,668 |
| Oct. 26, 2012 | Oct. 26, 2022 | 2.400 | 250,000,000 | (758,472) | (21,754,994) | 227,486,534 |
| Dec. 17, 2012 | Oct. 26, 2022 | 2.400 | 180,000,000 | (3,337,508) | (18,061,814) | 158,600,678 |
| Dec. 17, 2012 | Dec. 17, 2030 | 3.300 | 50,000,000 | – | (8,975,878) | 41,024,122 |
| Oct. 10, 2013 | Oct. 10, 2018 | 2.300 | 300,000,000 | (577,703) | (2,325,721) | 297,096,576 |
| Total notes payable | | | 1,030,000,000 | (5,072,433) | (34,189,989) | 990,737,578 |
| **Other borrowings** | | | | | | |
| Mar. 7, 2013 | Dec. 30, 2015 | 1.900% | 2,631,000 | – | – | 2,631,000 |
| Mar. 7, 2013 | Jun. 30, 2016 | 1.900 | 1,653,972 | – | – | 1,653,972 |
| Aug. 15, 2013 | Jun. 30, 2016 | 1.900 | 977,028 | – | – | 977,028 |
| Aug. 15, 2013 | Dec. 30, 2016 | 1.900 | 2,631,000 | – | – | 2,631,000 |
| Aug. 15, 2013 | Jun. 30, 2017 | 1.900 | 2,631,000 | – | – | 2,631,000 |
| Aug. 15, 2013 | Dec. 30, 2017 | 1.900 | 2,631,000 | – | – | 2,631,000 |
| Aug. 15, 2013 | Jun. 30, 2018 | 1.900 | 2,631,000 | – | – | 2,631,000 |
| Aug. 15, 2013 | Dec. 30, 2018 | 1.900 | 600,467 | – | – | 600,467 |
| Total other borrowings | | | 16,386,467 | – | – | 16,386,467 |
| | | | $ 1,046,386,467 | $ (5,072,433) | $ (34,189,989) | $ 1,007,124,045 |

### Notes Payable

The notes payable are unsecured, rank equally with all other unsecured indebtedness, and cannot be redeemed prior to their maturity, at which time they will be redeemed at 100% of their principal amount. Interest payments are due semiannually. Unamortized debt issuance costs related to these notes, which are included in other assets, totaled $4,267,313 and $5,024,500 at December 31, 2014 and 2013.

The fair value of the hedges relating to interest rate swaps on a portion of the notes payable was reported at December 31, 2014 as other assets of $18,433,614 and other liabilities of $13,386,334, and at December 31, 2013 as other assets of $16,928,418 and other liabilities of $51,118,407. For additional information on the fair value of financial instruments and derivatives, see Notes 11 and 12, respectively.

### Other Borrowings

On November 8, 2012, the Bank signed a loan commitment with another development bank to borrow up to $50 million to fund eligible projects in Mexico. This loan will amortize semiannually, with the first principal payment due on December 30, 2015 and final principal payment due on December 30, 2024. As of December 31, 2014, the Bank has borrowed $29,952,985. An annual commitment fee of 0.25% was assessed on the undisbursed loan commitment beginning in May 2013. For the years ended December 31, 2014 and 2013, these fees totaled $64,447 and $46,032, respectively.

## 6. Debt (continued)

The following table summarizes the maturities of the notes payable and other borrowings as of December 31, 2014 and 2013.

| | December 31 | |
|---|---|---|
| | 2014 | 2013 |
| Less than 1 year | **$ 2,631,000** | $ – |
| 1–2 years | **5,262,000** | 2,631,000 |
| 2–3 years | **5,262,000** | 5,262,000 |
| 3–4 years | **305,262,000** | 5,262,000 |
| 4–5 years | **305,263,000** | 303,231,467 |
| 5–10 years | **386,272,985** | 680,000,000 |
| More than 10 years | **50,000,000** | 50,000,000 |
| Total | **$ 1,059,952,985** | $ 1,046,386,467 |

The following table summarizes the short-term and long-term debt as of December 31, 2014 and 2013.

| | December 31 | |
|---|---|---|
| | 2014 | 2013 |
| Short-term debt: | | |
| Notes payable | **$ –** | $ – |
| Other borrowings | **2,631,000** | – |
| Total short-term debt | **2,631,000** | – |
| Long-term debt: | | |
| Notes payable | **1,030,000,000** | 1,030,000,000 |
| Other borrowings | **27,321,985** | 16,386,467 |
| Total long-term debt | **1,057,321,985** | 1,046,386,467 |
| Total debt | **$ 1,059,952,985** | $ 1,046,386,467 |

## 7. Equity

### Subscribed Capital

At December 31, 2014 and 2013, the Bank had authorized and subscribed 300,000 shares of capital stock, with a par value of $10,000 per share. As defined in the Charter, capital is classified as callable or paid-in at December 31, 2014 and 2013 as follows.

| | Mexico | | United States | | Total | |
|---|---|---|---|---|---|---|
| | Shares | Dollars | Shares | Dollars | Shares | Dollars |
| Subscribed capital | 150,000 | $ 1,500,000,000 | 150,000 | $ 1,500,000,000 | 300,000 | $ 3,000,000,000 |
| Less callable subscribed capital | (127,500) | (1,275,000,000) | (127,500) | (1,275,000,000) | (255,000) | (2,550,000,000) |
| Paid-in capital | 22,500 | 225,000,000 | 22,500 | 225,000,000 | 45,000 | 450,000,000 |
| Less transfer to General Reserve for Domestic Programs | – | (22,500,000) | – | (22,500,000) | – | (45,000,000) |
| Total funded paid-in capital | 22,500 | $ 202,500,000 | 22,500 | $ 202,500,000 | 45,000 | $ 405,000,000 |

The callable portion of the subscription for capital shares of the Bank will be subject to call only when required to meet obligations, as outlined in Article II, Section 3(d), of Chapter II of the Charter.

## 7. Equity (continued)

### Retained Earnings

Retained earnings are classified as designated, reserved, and undesignated by program, as follows:

| | December 31 2014 | December 31 2013 |
|---|---|---|
| **Designated retained earnings** | | |
| International Program: | | |
| Water Conservation Investment Fund (WCIF) | **$ 3,297,453** | $ 3,819,357 |
| Technical Assistance Program (TAP) | **4,904,334** | 5,284,984 |
| Community Assistance Program (CAP) | **10,677,156** | 11,473,415 |
| Total International Program | **18,878,943** | 20,577,756 |
| U.S. Domestic Program | **(1,158,994)** | (914,068) |
| Total designated retained earnings | **17,719,949** | 19,663,688 |
| **Reserved retained earnings** | | |
| International Program: | | |
| Debt Service Reserve | **19,991,327** | 18,431,594 |
| Operating Expenses Reserve | **10,396,093** | 9,375,607 |
| Special Reserve | **30,000,000** | 30,000,000 |
| Capital Preservation Reserve | **34,215,583** | 27,298,802 |
| Total International Program | **94,603,003** | 85,106,003 |
| U.S. Domestic Program: | | |
| Special Reserve | **20,752** | 34,667 |
| Total reserved retained earnings | **94,623,755** | 85,140,670 |
| **Undesignated retained earnings** | | |
| International Program | **24,392,203** | 16,013,735 |
| Total undesignated retained earnings | **24,392,203** | 16,013,735 |
| Total retained earnings | **$ 136,735,907** | $ 120,818,093 |
| **Retained earnings by program** | | |
| International Program | **$ 137,874,149** | $ 121,697,494 |
| U.S. Domestic Program | **(1,138,242)** | (879,401) |
| Total retained earnings | **$ 136,735,907** | $ 120,818,093 |

Additional information regarding the reserved funds and each program listed above is provided in Notes 2 and 9, respectively.

## 7. Equity (continued)

### Accumulated Other Comprehensive Income

The following table presents the changes in accumulated other comprehensive income (loss) for the years ended December 31, 2014 and 2013.

| | Beginning Balance | Period Activity | Ending Balance |
|---|---|---|---|
| **December 31, 2014** | | | |
| Unrealized gain (loss) on available-for-sale investment securities | **$ (771,259)** | **$ 729,968** | **$ (41,291)** |
| Foreign currency translation adjustment | **18,751** | **47,575** | **66,326** |
| Unrealized gain (loss) on hedging activities: | | | |
| Foreign currency translation adjustment | **(15,588,522)** | **(16,357,061)** | **(31,945,583)** |
| Fair value of cross-currency interest rate swaps | **8,290,675** | **23,435,855** | **31,726,530** |
| Net unrealized gain (loss) on hedging activities | **(7,297,847)** | **7,078,794** | **(219,053)** |
| Total accumulated other comprehensive gain (loss) | **$ (8,050,355)** | **$ 7,856,337** | **$ (194,018)** |
| **December 31, 2013** | | | |
| Unrealized gain (loss) on available-for-sale investment securities | $ 385,530 | $ (1,156,789) | $ (771,259) |
| Foreign currency translation adjustment | 59,935 | (41,184) | 18,751 |
| Unrealized gain (loss) on hedging activities: | | | |
| Foreign currency translation adjustment | (15,582,990) | (5,532) | (15,588,522) |
| Fair value of cross-currency interest rate swaps | 17,502,536 | (9,211,861) | 8,290,675 |
| Net unrealized gain (loss) on hedging activities | 1,919,546 | (9,217,393) | (7,297,847) |
| Total accumulated other comprehensive income (loss) | $ 2,365,011 | $ (10,415,366) | $ (8,050,355) |

## 8. Domestic Programs

As specified in the Charter, 10% of each country's paid-in capital is to be set aside to finance community adjustment and investment programs in support of the purposes of NAFTA. In accordance with the Charter, the Board of Directors approved transfers in prior years of $45,000,000, equal to 10% of paid-in capital of $450,000,000, to the General Reserve to support these programs. To further clarify operations related to these programs, the Bank entered into a Memorandum of Understanding (MOU) with each country. In accordance with the MOUs, the U.S. and Mexican programs are administered independently.

### Mexico

The MOU with Mexico indicates that 10% of paid-in capital from Mexico and the related earnings be set aside for the community adjustment and investment program endorsed by Mexico. The Mexican federal government instituted its domestic program, titled *Programa Complementario de Apoyo a Comunidades y Empresas* (Mexican Domestic Program), through the offices of the SHCP. In June 1996, the SHCP entered into a mandate agreement with Banobras to receive and administer the funds allocated for this program. The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999. Accordingly, the activities of the Mexican Domestic Program are not reflected as operations of the Bank.

### United States

The MOU with the U.S. government specifies that 10% of the paid-in capital from the United States and the related earnings be set aside for the U.S. Community Adjustment and Investment Program (U.S. Domestic Program). The Bank provides financing endorsed by the Finance Committee appointed by the U.S. government for that purpose.

## 8. Domestic Programs (continued)

In accordance with the Charter and MOU with the United States, net assets of the Bank in the amounts of $3,198,834 and $4,894,188 were designated for the U.S. Domestic Program at December 31, 2014 and 2013, respectively. The revenue related to these amounts for the years ended December 31, 2014 and 2013 were $42,906 and $58,104, respectively. Additionally, expenses directly related to the operation of the U.S. Domestic Program of $301,055 and $286,147 are included in the operations of the Bank for the years ended December 31, 2014 and 2013, respectively. All expenses and disbursements are paid out of the U.S. Domestic Program funds. Deficit retained earnings on the U.S. Domestic Program capital funds as of December 31, 2014 and 2013 were $1,138,242 and $879,401, respectively. Under the U.S. Domestic Program, $2,570,194 in cash and cash equivalents was available for disbursement as of December 31, 2014.

In January 2009, the Finance Committee approved a Targeted Grant Program (TGP) to be funded with the remaining balance of the U.S. Domestic Program's allocated paid-in capital. As of December 31, 2014 and 2013, the U.S. Domestic Program's allocated paid-in capital totaled $4,337,076 and $5,773,589, respectively. For the years ended December 31, 2014 and 2013, $1,436,513 and $829,249, respectively, were disbursed through the TGP. These disbursements were reported as a deduction from allocated paid-in capital.

## 9. Program Activities

Program activities are comprised of the following:

| | Year Ended December 31 | |
|---|---|---|
| | 2014 | 2013 |
| Program income: | | |
| EPA grant | **$ 1,041,909** | $ 1,207,801 |
| Total program income | **1,041,909** | 1,207,801 |
| Program expenses: | | |
| EPA grant administration | **(1,041,909)** | (1,207,801) |
| Technical Assistance Program | **(759,069)** | (689,865) |
| Water Conservation Investment Fund | **(521,904)** | (455,025) |
| Community Assistance Program | **(796,259)** | – |
| Total program expenses | **(3,119,141)** | (2,352,691) |
| Net program expenses | **$ (2,077,232)** | $ (1,144,890) |

### EPA Grants

The Bank administers grant funds from EPA through the Border Environment Infrastructure Fund (BEIF). EPA grant awards since the initial grant made in April 1997 to December 31, 2014 total $678,230,665. Under the terms of the grants, the Bank reviews and submits prospective projects to EPA, which approves the projects. EPA then disburses funds to the Bank, which directs the grant monies to the specified project. The Bank also oversees progress and compliance requirements for EPA and receives an allocation of the EPA grant funds for administrative expenses incurred.

As of December 31, 2014, EPA has approved project funding proposed by the Bank totaling $622,284,398, of which $583,931,895 has been disbursed through the Bank. The Bank recognized $1,041,909 and $1,207,801 as reimbursement of expenses incurred for the years ended December 31, 2014 and 2013, respectively. These funds have been recorded as program revenue and expenses in the consolidated statements of income.

## 9. Program Activities (continued)

### Technical Assistance Program (TAP)

The Bank uses a portion of its retained earnings as authorized by the Board of Directors to offer technical assistance and training to project sponsors for the purpose of strengthening their financial performance and ensuring the long-term sustainability of their infrastructure. Through the TAP, assistance is provided for studies related to the design and implementation of environmental infrastructure projects, as well as for capacity-building measures aimed at achieving the effective and efficient operation of public services. For the years ended December 31, 2014 and 2013, $380,650 and $261,047, respectively, was disbursed under this program. These disbursements were funded with previously designated retained earnings and have been reported as a program expense.

As part of its technical assistance program, the Utility Management Institute (UMI) provides water utility managers and their staff with an opportunity for ongoing professional development aimed at enhancing their managerial and financial skills. For the years ended December 31, 2014 and 2013, $378,419 and $428,818, respectively, was expended under this program.

### Water Conservation Investment Fund (WCIF)

In August 2002, the Board of Directors established the WCIF program to finance water conservation projects in the U.S.-Mexico border region and designated $80,000,000 of the Bank's undesignated retained earnings to the WCIF. Of that amount, $40,000,000 was reserved exclusively for water conservation projects in each country. For the years ended December 31, 2014 and 2013, $521,904 and $455,025, respectively, were disbursed under this fund. As of December 31, 2014, cumulative disbursements total $35,656,644 for the United States and $39,990,407 for Mexico. These disbursements were funded with previously designated retained earnings and have been reported as a program expense.

In May 2013, the Board agreed to close out the WCIF and transfer any uncommitted funds to the CAP program. In December 2013, a cumulative total of $1,055,196 in uncommitted WCIF funds was transferred to the CAP program.

### Community Assistance Program (CAP)

In February 2011, the Board of Directors approved a grant program to support public projects in all sectors eligible for Bank financing. The CAP program is funded from the Bank's undesignated retained earnings as authorized by the Board. As of December 31, 2014, a cumulative total of $11,473,415 has been allocated to the CAP. For the years ended December 31, 2014 and 2013, $796,259 and $0, respectively, were disbursed under this program. These disbursements were funded with previously designated retained earnings and have been reported as a program expense.

## 10. 401(a) Retirement Plan

The Bank has a 401(a) Retirement Plan (the Plan) for its employees. The Plan provides for employee and nondiscretionary employer contributions. For the years ended December 31, 2014 and 2013, the Bank expended $576,393 and $587,750, respectively, relating to the Plan.

## 11. Fair Value of Financial Instruments

Information on how the Bank measures fair value and classifies the levels of the fair value inputs is provided in Note 2.

### Cash and Cash Equivalents

The carrying amounts for cash and cash equivalents approximate their fair value.

## 11. Fair Value of Financial Instruments (continued)

### Securities Held-to-Maturity

Securities classified as held-to-maturity are reported at amortized costs. The fair value of these securities is estimated using Level 2 observable inputs. For these securities, the Bank obtains fair value measurements from an independent pricing service which, in its understanding, are based on prices quoted for a similar instrument.

### Securities Available-for-Sale

Securities classified as available-for-sale are reported at fair value using Level 1 and Level 2 observable inputs. For these securities, the Bank obtains fair value measurements from an independent pricing service which, in its understanding, are based on prices quoted for the exact or like-kind instrument.

### Loans Receivable and Interest Receivable

The fair value of loans is estimated based on Level 2 observable inputs using discounted cash flow analyses and using interest rates currently being offered for loans made by the Bank with similar terms to borrowers of similar credit quality, net of allowance for loan loss. The fair value of nonaccrual loans is estimated to equal the aggregate net realizable value of the underlying collateral and guaranties. The carrying amount of accrued interest approximates its fair value. This valuation does not consider liquidity discounts currently being used by certain market participants, since measuring their impact would not be cost-beneficial for the Bank, given the nature of its loan portfolio.

### Cross-currency Interest Rate Swaps

Cross-currency interest rate swaps are reported at fair value using Level 3 unobservable inputs. The fair value of these swaps is estimated based on discounting procedures, whereby each cash flow stream is discounted using the benchmark swap curve of the respective currency and converting the resulting net present value at the spot exchange rate, as well as external pricing models and counterparty pricing. The Bank's market cross-currency swaps are all Mexican-peso for U.S.-dollar operations. Mexican-peso cash flows are discounted using the Mexico Benchmark Interbank Deposit Rate (TIIE) 28-day swap curve. U.S.-dollar cash flows are discounted using the 3-month London Interbank Offered Rate (LIBOR) swap curve.

### Interest Rate Swaps

Interest rate swaps are reported at fair value using Level 3 unobservable inputs. The fair value of these swaps is estimated based on discounting procedures, whereby each cash flow stream is discounted using the benchmark 3-month LIBOR swap curve, as well as external pricing models and counterparty pricing.

### Hedged Items for Loans

Hedged items for loans are reported at fair value using Level 3 unobservable inputs. The fair value of these hedged items is estimated by discounting each cash flow stream using the benchmark swap curve of the contractual currency and converting the resulting net present value at the spot exchange rate, as well as external pricing models and counterparty pricing. Mexican-peso cash flows are discounted using the TIIE 28-day swap curve. U.S.-dollar cash flows are discounted using the 3-month LIBOR swap curve.

### Other Real Estate Owned

Other real estate owned is reported at fair value using Level 3 unobservable inputs based on customized discounting criteria.

### Hedged Items for Notes Payable

Hedged items for notes payable are reported at fair value using Level 3 unobservable inputs. The fair value of the hedged items is estimated based on discounting procedures, whereby each cash flow stream is discounted using the benchmark 3-month LIBOR swap curve, as well as external pricing models and counterparty pricing.

## 11. Fair Value of Financial Instruments (continued)

### Debt and Accrued Interest Payable

The notes payable and other borrowings are carried at amortized cost. The fair value of the debt is estimated by discounting the cash flow stream using the benchmark swap curve. The carrying amount of accrued interest payable approximates its fair value.

The carrying amounts and fair value of the Bank's financial instruments are as follows:

| | December 31, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| **Assets** | | | | |
| Cash and cash equivalents | **$ 87,656,071** | **$ 87,656,071** | $ 60,604,326 | $ 60,604,326 |
| Held-to-maturity securities | **53,664,254** | **58,920,540** | 53,619,703 | 59,177,603 |
| Available-for-sale securities | **304,203,394** | **304,203,394** | 435,095,011 | 435,095,011 |
| Loans, net | **1,135,098,837** | **1,149,694,238** | 962,798,909 | 964,294,826 |
| Interest receivable | **10,458,143** | **10,458,143** | 10,331,837 | 10,331,837 |
| Cross-currency interest rate swaps | **36,938,315** | **36,938,315** | 20,059,058 | 20,059,058 |
| Interest rate swaps | **18,433,614** | **18,433,614** | 26,962,548 | 26,962,548 |
| Other real estate owned | **5,953,307** | **5,953,307** | 7,833,038 | 7,833,038 |
| **Liabilities** | | | | |
| Accrued interest payable | **8,394,741** | **8,394,741** | 8,343,188 | 8,343,188 |
| Short-term debt | **2,631,000** | **2,631,000** | – | – |
| Cross-currency interest rate swaps | **–** | **–** | 6,606,616 | 6,606,616 |
| Interest rate swaps | **20,426,135** | **20,426,135** | 50,763,499 | 50,763,499 |
| Long-term debt, net | **1,052,838,328** | **1,059,961,530** | 1,041,314,034 | 1,003,770,775 |

The Bank's financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2014 and 2013 are summarized in the following table by the valuation level of the inputs used to measure fair value. Additional information on how the Bank measures and classifies the levels of fair-value inputs is provided in Note 2.

## 11. Fair Value of Financial Instruments (continued)

| | Fair Value Measurements Using | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total Fair Value |
| **December 31, 2014** | | | | |
| **Assets** | | | | |
| Available-for-sale (AFS) securities: | | | | |
| U.S. government securities | **$ 106,169,314** | **$ –** | **$ –** | **$ 106,169,314** |
| U.S. agency securities | **–** | **68,827,189** | **–** | **68,827,189** |
| Corporate debt securities | **–** | **83,965,378** | **–** | **83,965,378** |
| Other fixed-income securities | **–** | **30,154,558** | **–** | **30,154,558** |
| Mexican government securities (UMS) | **–** | **15,063,742** | **–** | **15,063,742** |
| Mortgage-backed securities | **–** | **23,213** | **–** | **23,213** |
| Total AFS securities | **106,169,314** | **198,034,080** | **–** | **304,203,394** |
| Cross-currency interest rate swaps | **–** | **–** | **36,938,315** | **36,938,315** |
| Interest rate swaps | **–** | **–** | **18,433,614** | **18,433,614** |
| Hedged items for loans | **–** | **–** | **1,698,406** | **1,698,406** |
| Total assets at fair value | **$ 106,169,314** | **$ 198,034,080** | **$ 57,070,335** | **$ 361,273,729** |
| **Liabilities** | | | | |
| Cross-currency interest rate swaps | **$ –** | **$ –** | **$ –** | **$ –** |
| Interest rate swaps | **–** | **–** | **20,426,135** | **20,426,135** |
| Hedged item for notes payable | **–** | **–** | **5,047,280** | **5,047,280** |
| Total liabilities at fair value | **$ –** | **$ –** | **$ 25,473,415** | **$ 25,473,415** |
| **December 31, 2013** | | | | |
| **Assets** | | | | |
| Available-for-sale (AFS) securities: | | | | |
| U.S. government securities | $ 176,805,681 | $ – | $ – | $ 176,805,681 |
| U.S. agency securities | – | 92,281,412 | – | 92,281,412 |
| Corporate debt securities | – | 104,601,368 | – | 104,601,368 |
| Other fixed-income securities | – | 42,955,204 | – | 42,955,204 |
| Mexican government securities (UMS) | – | 18,372,500 | – | 18,372,500 |
| Mortgage-backed securities | – | 78,846 | – | 78,846 |
| Total AFS securities | 176,805,681 | 258,289,330 | – | 435,095,011 |
| Cross-currency interest rate swaps | – | – | 20,059,058 | 20,059,058 |
| Interest rate swaps | – | – | 26,962,548 | 26,962,548 |
| Hedged items for loans | – | – | (17,343,992) | (17,343,992) |
| Total assets at fair value | $ 176,805,681 | $ 258,289,330 | $ 29,677,614 | $ 464,772,625 |
| **Liabilities** | | | | |
| Cross-currency interest rate swaps | $ – | $ – | $ 6,606,616 | $ 6,606,616 |
| Interest rate swaps | – | – | 50,763,499 | 50,763,499 |
| Hedged item for notes payable | – | – | (34,189,989) | (34,189,989) |
| Total liabilities at fair value | $ – | $ – | $ 23,180,126 | $ 23,180,126 |

## 11. Fair Value of Financial Instruments (continued)

The following table summarizes the changes to the financial assets and liabilities measured at fair value on a recurring basis using unobservable inputs (Level 3) during the years ended December 31, 2014 and 2013. Additional information on how the Bank measures fair value is provided in Note 2.

| | Fair Value of Level 3 Instruments | | |
|---|---|---|---|
| | Cross-currency Interest Rate Swaps | Interest Rate Swaps | Hedged Items |
| **Assets** | | | |
| Beginning balance, January 1, 2014 | **$ 20,059,058** | **$ 26,962,548** | **$ (17,343,992)** |
| Total realized and unrealized gains (losses): | | | |
| Included in earnings (expenses) | **(6,255,478)** | **(8,528,934)** | **19,042,398** |
| Included in other comprehensive income (loss) | **23,435,855** | – | – |
| Purchases | – | – | – |
| Settlements | **(301,120)** | – | – |
| Transfers in/out of Level 3 | – | – | – |
| Ending balance, December 31, 2014 | **$ 36,938,315** | **$ 18,433,614** | **$ 1,698,406** |
| Beginning balance, January 1, 2013 | $ 22,321,693 | $ 31,817,912 | $ 9,451,273 |
| Total realized and unrealized gains (losses): | | | |
| Included in earnings (expenses) | (621,786) | (4,855,364) | (26,795,265) |
| Included in other comprehensive income (loss) | (1,640,849) | – | – |
| Purchases | – | – | – |
| Settlements | – | – | – |
| Transfers in/out of Level 3 | – | – | – |
| Ending balance, December 31, 2013 | $ 20,059,058 | $ 26,962,548 | $ (17,343,992) |
| **Liabilities** | | | |
| Beginning balance, January 1, 2014 | **$ 6,606,616** | **$ 50,763,499** | **$ (34,189,989)** |
| Total realized and unrealized (gains) losses: | | | |
| Included in (earnings) expenses | **(5,641,616)** | **(30,337,364)** | **39,237,269** |
| Included in other comprehensive (income) loss | – | – | – |
| Purchases | – | – | – |
| Settlements | **(965,000)** | – | – |
| Transfers in/out of Level 3 | – | – | – |
| Ending balance, December 31, 2014 | **$ –** | **$ 20,426,135** | **$ 5,047,280** |
| Beginning balance, January 1, 2013 | $ 7,697,783 | $ 11,417,251 | $ 28,404,469 |
| Total realized and unrealized (gains) losses: | | | |
| Included in (earnings) expenses | (8,662,178) | 39,346,248 | (62,594,458) |
| Included in other comprehensive (income) loss | 7,571,011 | – | – |
| Purchases | – | – | – |
| Settlements | – | – | – |
| Transfers in/out of Level 3 | – | – | – |
| Ending balance, December 31, 2013 | $ 6,606,616 | $ 50,763,499 | $ (34,189,989) |

## 11. Fair Value of Financial Instruments (continued)

The Bank entered into 14 cross-currency interest rate swaps and three interest rate swaps during the year ended December 31, 2014. Upon issuance, the fair value of the swaps is $0 and, therefore, is not portrayed in the purchases line item in the preceding table. The change in fair value of these instruments is included within the total gains (losses) line item.

The Bank has no nonfinancial assets or liabilities measured at fair value on a recurring basis. Certain nonfinancial assets and liabilities measured at fair value on a nonrecurring basis include foreclosed assets (upon initial recognition or subsequent impairment) and other nonfinancial long-lived assets measured at fair value for impairment assessment. In March 2012, the Bank foreclosed on the collateral of one loan under the International Program with a net asset value of $800,000. During October 2012 and February 2013, a portion of this collateral was sold for cash for $146,693. In December 2013, the Bank foreclosed on a loan under the International Program and received as partial payment collateral with a net asset value of $7,179,731. The fair value of the collateral from the foreclosed loans is measured using Level 3 unobservable inputs and is reported in other assets as other real estate owned of $5,953,307 and $7,833,038 at December 31, 2014 and 2013, respectively. For the year ended December 31, 2014 and 2013 the Bank recorded an impairment on the other real estate owned of $1,533,203 and $0, respectively. The impairment is recorded in other expenses in the consolidated statement of income.

The fair value of these hedges was reported in the accompanying consolidated balance sheets at December 31, 2014 as other assets of $36,938,315 and other liabilities of $7,039,801 and at December 31, 2013 as other assets of $30,093,188 and other liabilities of $6,251,708.

## 12. Derivative Financial Instruments

The Bank utilizes cross-currency interest rate swaps to mitigate exposure to fluctuations in foreign currency exchange rates and interest rate swaps to mitigate exposure to fluctuations in interest rates. The fair value of the swaps outstanding as of each reporting period end is included in other assets or other liabilities, depending on whether the Bank is in a favorable or unfavorable position as of the reporting period date.

The Bank enters into cross-currency interest rate swaps that are matched to specific fixed, variable, or adjustable rate loans denominated in Mexican pesos that the Bank has entered into directly with the borrower or with COFIDAN. In the latter case, COFIDAN then enters into loans denominated in Mexican pesos under the exact same terms with its borrowers. The swaps have been designated as hedging instruments because they hedge the risk of fluctuations in cash flows due to changes in foreign currency exchange rates. The swaps are structured so that the notional amounts decrease over time to match the expected amortization of the underlying loan.

The Bank enters into interest rate swaps that are matched to the terms of loans and to a portion of its long-term notes payable. The swaps have been designated as hedging instruments, because they hedge the risk of changes in the fair value of fixed-rate loans and notes payable due to changes in the designated benchmark interest rate. The Bank designated the LIBOR swap rate as the benchmark interest rate. The swaps are structured so that the notional amounts mature to match the expected maturity of the loans and the notes payable.

Neither the Bank nor the counterparty is required to post collateral to support the outstanding fair value of the swaps under its arrangement with FOAEM. Beginning in July 2009, under counterparty relationships with other financial institutions, collateral may be required to be posted by either the Bank or the counterparty. Cash collateral of $21,900,000 and $4,800,000 was posted from a counterparty to the Bank as of December 31, 2014 and 2013, respectively. Cash collateral of $0 and $19,720,000 was posted by the Bank as of December 31, 2014 and 2013, respectively.

## 12. Derivative Financial Instruments (continued)

The notional amounts and estimated fair values of the swaps outstanding at December 31, 2014 and 2013 are presented in the following table. The fair value of these swaps is estimated using internal valuation models with observable market data inputs.

| | December 31, 2014 | | December 31, 2013 | |
|---|---|---|---|---|
| | Notional Amount | Estimated Fair Value | Notional Amount | Estimated Fair Value |
| Cross-currency interest rate swaps | **$ 386,697,778** | **$ 36,938,315** | $ 339,577,373 | $ 14,560,033 |
| Interest rate swaps | **1,295,780,184** | **(1,992,521)** | 1,190,487,286 | (23,800,951) |

The referenced exchange rate received for the cross-currency interest rate swaps outstanding at December 31, 2014 and 2013 was 6.77% and 7.67%, respectively.

Swaps that are no longer deemed effective because of borrower default on the hedged loans are not included in the preceding table. The fair value of these swaps was $(1,107,591) as of December 31, 2013. There were no swaps that were considered ineffective due to borrower default as of December 31, 2014.

### Gains and Losses on Derivative Cash Flows

*Cross-currency Interest Rate Swaps* – The effective portion of the gain or loss due to changes in the fair value of cross-currency interest rate swaps designated as cash flow hedges is included in the accompanying consolidated statements of comprehensive income, while the ineffective portion is included in other income or expense. The accumulated gain (loss) is reclassified into earnings as the hedged cash flows are received to offset the foreign currency gains (losses) that would have been recognized in earnings if the Bank had not been a party to the swaps. The accumulated net loss related to the swaps included in accumulated other comprehensive income totaled $(219,053) and $(7,297,847) at December 31, 2014 and 2013, respectively.

Gains or losses due to changes in the fair value of cross-currency interest rate swaps designated as fair value hedges and ineffective swaps are reported in other income or expense. For the years ended December 31, 2014 and 2013, changes in the aforementioned swaps included in the accompanying consolidated statements of income were $2,062,718 and $(868,552), respectively.

*Interest Rate Swaps* – With regard to the interest rate swaps on outstanding loans and a portion of the long-term notes payable, the changes in the fair value of the swaps offset the changes in the fair value of the loans and debt due to changes in the LIBOR swap rate, while the ineffective portion is included in other income or expense. For the years ended December 31, 2014 and 2013, changes in the aforementioned swaps included in the accompanying consolidated statements of income were $(1,069,359) and $0, respectively.

## 13. Credit Risk Associated with Financial Instruments

The Bank is subject to certain credit risk. Financial instruments that potentially subject the Bank to significant concentrations of credit risk consist principally of cash, investments, loans receivable, and swaps. The Bank maintains cash and cash equivalents, investments, and certain other financial instruments with various major financial institutions. The Bank performs periodic evaluations of the relative credit standing of these financial institutions and limits the amount of credit exposure with any one institution. The Bank evaluates the creditworthiness of each customer on a case-by-case basis and continually monitors the financial stability of each borrower.

## 14. Commitments

In the normal course of business, the Bank has various outstanding commitments, in addition to the loan receivables disclosed in Note 4 and the long-term borrowings disclosed in Note 6. Under agreements with consultants and contractors in effect at December 31, 2014, the Bank has obligations to make payments contingent upon the future performance of the consultants and contractors under the terms of their respective contracts and, therefore, they are not recorded in the financial statements.

## 15. Accounting Standards Updates

Accounting Standards Update (ASU) 2013-10, *Derivatives and Hedging (Topic 815) – Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes*. ASU 2013-10 permits the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) to be used as a U.S. benchmark interest rate for hedge accounting purposes under Topic 815, in addition to interest rates on direct Treasury obligations of the U.S. government and the London Interbank Offered Rate (LIBOR). ASU 2013-10 is effective for qualifying new or re-designated hedging relationships entered into on or after July 17, 2013 and did not have a significant impact to the Bank's consolidated financial statements.

ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. ASU 2014-09 implements a common revenue standard that clarifies the principles for recognizing revenue. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (i) identify the contract(s) with a customer, (ii) identify the performance obligations in the contract, (iii) determine the transaction price, (iv) allocate the transaction price to the performance obligations in the contract and (v) recognize revenue when (or as) the entity satisfies a performance obligation. ASU 2014-09 is effective for the Bank on January 1, 2017. The Bank does not anticipate a significant impact to the Bank's consolidated financial statements since the primary source of revenue is from interest income from loans and investments.

ASU 2015-01, *Income Statement – Extraordinary and Unusual Items (Subtopic 225-20) – Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*. ASU 2015-01 eliminates from U.S. GAAP the concept of extraordinary items, which, among other things, required an entity to segregate extraordinary items considered to be unusual and infrequent from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. ASU 2015-01 is effective for the Bank beginning January 1, 2016, though early adoption is permitted. ASU 2015-01 is not expected to have a significant impact on the Bank's financial statements.

## 16. Other Significant Event

On December 3, 2014, the Board approved a resolution recommending the merger of NADB and BECC into a single institution. The proposed integration would preserve the current mission, purposes and functions of both organizations, including the environmental mandate and geographic jurisdiction of the institutions.

## 17. Subsequent Events

The Bank has evaluated subsequent events for potential recognition and/or disclosure through March 31, 2015, the date these consolidated financial statements were issued.

# Supplementary Information

North American Development Bank

# Combining Balance Sheet by Program

December 31, 2014

| | International Program | U.S. Domestic Program (A) | Eliminations | Total |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents: | | | | |
| Held at other financial institutions in demand deposit accounts | $ 1,836,456 | $ 34 | $ – | $ 1,836,490 |
| Held at other financial institutions in interest-bearing accounts | 52,349,421 | 570,160 | – | 52,919,581 |
| Repurchase agreements | 30,900,000 | 2,000,000 | – | 32,900,000 |
| | 85,085,877 | 2,570,194 | – | 87,656,071 |
| Held-to-maturity investment securities, at amortized cost | 53,664,254 | – | – | 53,664,254 |
| Available-for-sale investment securities, at fair value | 304,203,394 | – | – | 304,203,394 |
| Loans outstanding | 1,185,514,182 | 691,749 | – | 1,186,205,931 |
| Allowance for loan losses | (11,355,628) | (23,188) | – | (11,378,816) |
| Unamortized loan fees | (8,535,936) | – | – | (8,535,936) |
| Foreign currency exchange rate adjustment | (32,890,748) | – | – | (32,890,748) |
| Hedged items, at fair value | 1,698,406 | – | – | 1,698,406 |
| Net loans outstanding | 1,134,430,276 | 668,561 | – | 1,135,098,837 |
| Interest receivable | 10,456,118 | 2,025 | – | 10,458,143 |
| Grant and other receivable | 1,631,316 | – | – | 1,631,316 |
| Due from U.S. Domestic Program | 29,236 | – | (29,236) | – |
| Furniture, equipment and leasehold improvements, net | 175,938 | 1,383 | – | 177,321 |
| Other assets | 43,692,549 | – | – | 43,692,549 |
| Total assets | $ 1,633,368,958 | $ 3,242,163 | $ (29,236) | $ 1,636,581,885 |
| **Liabilities and equity** | | | | |
| Liabilities: | | | | |
| Accounts payable | $ 1,066,206 | $ – | $ – | $ 1,066,206 |
| Accrued liabilities | 278,132 | 14,093 | – | 292,225 |
| Due to International Program | – | 29,236 | (29,236) | – |
| Accrued interest payable | 8,394,741 | – | – | 8,394,741 |
| Undisbursed grant funds | 1,000 | – | – | 1,000 |
| Other liabilities | 20,426,135 | – | – | 20,426,135 |
| Short-term debt | 2,631,000 | – | – | 2,631,000 |
| Long-term debt, net of discount | 1,052,838,328 | – | – | 1,052,838,328 |
| Hedged items, at fair value | 5,047,280 | – | – | 5,047,280 |
| Net long-term debt | 1,057,885,608 | – | – | 1,057,885,608 |
| Total liabilities | 1,090,682,822 | 43,329 | (29,236) | 1,090,696,915 |
| Equity: | | | | |
| Paid-in capital | 405,000,000 | – | – | 405,000,000 |
| General Reserve: | | | | |
| Allocated paid-in capital | – | 4,337,076 | – | 4,337,076 |
| Retained earnings: | | | | |
| Designated | 18,878,943 | (1,158,994) | – | 17,719,949 |
| Reserved | 94,603,003 | 20,752 | – | 94,623,755 |
| Undesignated | 24,392,203 | – | – | 24,392,203 |
| Accumulated other comprehensive loss | (194,018) | – | – | (194,018) |
| Non-controlling interest | 6,005 | – | – | 6,005 |
| Total equity | 542,686,136 | 3,198,834 | – | 545,884,970 |
| Total liabilities and equity | $ 1,633,368,958 | $ 3,242,163 | $ (29,236) | $ 1,636,581,885 |

*Note A – The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999.*

North American Development Bank

# Combining Statement of Income by Program

Year Ended December 31, 2014

| | International Program | U.S. Domestic Program (A) | Total |
|---|---|---|---|
| Income: | | | |
| Interest: | | | |
| Investment income | $ 5,223,619 | $ 1,115 | $ 5,224,734 |
| Loan income | 38,486,533 | 41,791 | 38,528,324 |
| Gain on sales of available-for-sale investment securities, net | 188,097 | – | 188,097 |
| Fee income | 17,257 | – | 17,257 |
| Other | 1,038,329 | – | 1,038,329 |
| Total revenues | 44,953,835 | 42,906 | 44,996,741 |
| Operating expenses: | | | |
| Personnel | 4,877,951 | – | 4,877,951 |
| Consultants and contractors | 2,380,353 | – | 2,380,353 |
| General and administrative | 1,070,094 | – | 1,070,094 |
| Operational travel | 238,823 | – | 238,823 |
| Depreciation | 49,046 | 692 | 49,738 |
| Provision for loan losses | 2,199,499 | – | 2,199,499 |
| Other | 2,336,949 | – | 2,336,949 |
| U.S. Domestic Program | – | 301,055 | 301,055 |
| Total operating expenses | 13,152,715 | 301,747 | 13,454,462 |
| Interest expense | 13,547,601 | – | 13,547,601 |
| Income (loss) before program activities | 18,253,519 | (258,841) | 17,994,678 |
| Program activities: | | | |
| EPA grant income | 1,041,909 | – | 1,041,909 |
| EPA grant administration | (1,041,909) | – | (1,041,909) |
| TAP | (759,069) | – | (759,069) |
| CAP | (796,259) | – | (796,259) |
| WCIF | (521,904) | – | (521,904) |
| Net program expenses | (2,077,232) | – | (2,077,232) |
| Income (loss) before non-controlling interest | 16,176,287 | (258,841) | 15,917,446 |
| Net loss attributable to non-controlling interest | (368) | – | (368) |
| Net income (loss) | $ 16,176,655 | $ (258,841) | $ 15,917,814 |
| **General Reserve, January 1, 2014** | | | |
| Allocated paid-in capital | $ – | $ 5,773,589 | $ 5,773,589 |
| Retained earnings | 121,697,494 | (879,401) | 120,818,093 |
| Current period activity: | | | |
| Net income (loss) | 16,176,655 | (258,841) | 15,917,814 |
| TGP disbursements of the U.S. Domestic Program | – | (1,436,513) | (1,436,513) |
| **General Reserve, December 31, 2014** | | | |
| Allocated paid-in capital | – | 4,337,076 | 4,337,076 |
| Retained earnings | 137,874,149 | (1,138,242) | 136,735,907 |
| | $ 137,874,149 | $ 3,198,834 | $ 141,072,983 |

*Note A – The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999.*

North American Development Bank

# Combining Statement of Comprehensive Income by Program

Year Ended December 31, 2014

| | International Program | U.S. Domestic Program (A) | Total |
|---|---|---|---|
| Net income (loss) | $ 16,176,655 | $ (258,841) | $ 15,917,814 |
| Other comprehensive income (loss): | | | |
| Available-for-sale investment securities: | | | |
| Change in unrealized gains during the period, net | 918,065 | – | 918,065 |
| Reclassification adjustment for net gain included in net income | (188,097) | – | (188,097) |
| Total unrealized gain on available-for-sale investment securities | 729,968 | – | 729,968 |
| Foreign currency translation adjustment | 47,575 | – | 47,575 |
| Unrealized gains (losses) on hedging activities: | | | |
| Foreign currency translation adjustment, net | (16,357,061) | – | (16,357,061) |
| Fair value of cross-currency interest rate swaps, net | 23,435,855 | – | 23,435,855 |
| Total unrealized gain on hedging activities | 7,078,794 | – | 7,078,794 |
| Total other comprehensive income | 7,856,337 | – | 7,856,337 |
| Total comprehensive income (loss) | $ 24,032,992 | $ (258,841) | $ 23,774,151 |

*Note A – The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999.*

North American Development Bank

# Combining Statement of Cash Flows by Program

Year Ended December 31, 2014

| | International Program | U.S. Domestic Program (A) | Total |
|---|---|---|---|
| **Operating activities** | | | |
| Net income (loss) | $ 16,176,655 | $ (258,841) | $ 15,917,814 |
| Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: | | | |
| Depreciation | 49,046 | 692 | 49,738 |
| Amortization of net premium on investments | 2,582,651 | – | 2,582,651 |
| Change in fair value of swaps and other non-cash items | 41,396,025 | – | 41,396,025 |
| Non-controlling interest | (368) | – | (368) |
| Gain on sales of available-for-sale investment securities, net | (188,097) | – | (188,097) |
| Provision for loan losses | 2,199,499 | – | 2,199,499 |
| Change in other assets and liabilities: | | | |
| (Increase) decrease in interest receivable | (127,767) | 1,461 | (126,306) |
| Decrease in receivable and other assets | 1,425,083 | – | 1,425,083 |
| Increase (decrease) in due from U.S. Domestic Program due to International Program | (3,222) | 3,222 | – |
| Increase in accounts payable | 72,670 | – | 72,670 |
| Increase (decrease) in accrued liabilities | (32,438) | 2,307 | (30,131) |
| Increase in accrued interest payable | 51,553 | – | 51,553 |
| Net cash provided by (used in) operating activities | 63,601,290 | (251,159) | 63,350,131 |
| **Lending, investing, and development activities** | | | |
| Capital expenditures | (34,109) | – | (34,109) |
| Loan principal repayments | 76,121,947 | 463,819 | 76,585,766 |
| Loan disbursements | (254,162,523) | – | (254,162,523) |
| Purchase of held-to-maturity investments | (3,224,685) | – | (3,224,685) |
| Purchase of available-for-sale investments | (295,316,846) | – | (295,316,846) |
| Proceeds from maturities of held-to-maturity investments | 3,203,000 | – | 3,203,000 |
| Proceeds from sales and maturities of available-for-sale investments | 424,521,011 | – | 424,521,011 |
| Net cash provided by (used in) lending, investing, and development activities | (48,892,205) | 463,819 | (48,428,386) |
| **Financing activities** | | | |
| Proceeds from other borrowings | 13,566,518 | – | 13,566,518 |
| Grant funds – EPA | 15,672,030 | – | 15,672,030 |
| Grant disbursements – EPA | (15,672,035) | – | (15,672,035) |
| Grant activity – U.S. Domestic Program | – | (1,436,513) | (1,436,513) |
| Net cash provided by (used in) financing activities | 13,566,513 | (1,436,513) | 12,130,000 |
| Net increase (decrease) in cash and cash equivalents | 28,275,598 | (1,223,853) | 27,051,745 |
| Cash and cash equivalents at January 1, 2014 | 56,810,279 | 3,794,047 | 60,604,326 |
| Cash and cash equivalents at December 31, 2014 | $ 85,085,877 | $ 2,570,194 | $ 87,656,071 |

*Note A – The Mexican Domestic Program funds were fully transferred to Mexico as of June 1999.*

North American Development Bank

# Border Environment Infrastructure Fund (BEIF)

As of and for the Year Ended December 31, 2014

**Balance Sheet**

| | Region 6 | Region 9 | Total |
|---|---|---|---|
| **Assets** | | | |
| Cash | $ 500 | $ 500 | $ 1,000 |
| Total assets | $ 500 | $ 500 | $ 1,000 |
| **Liabilities** | | | |
| Undisbursed grant funds | $ 500 | $ 500 | $ 1,000 |
| Total liabilities | $ 500 | $ 500 | $ 1,000 |

**Statement of Income**

| | Region 6 | Region 9 | Total |
|---|---|---|---|
| Income: | | | |
| U.S. Environmental Protection Agency grant income | $ 439,017 | $ 602,891 | $ 1,041,908 |
| Total income | 439,017 | 602,891 | 1,041,908 |
| BEIF operating expenses: | | | |
| Personnel | 276,720 | 278,128 | 554,848 |
| Consultants | 113,367 | 264,012 | 377,379 |
| General and administrative | 24,674 | 24,160 | 48,834 |
| Operational travel | 24,256 | 36,591 | 60,847 |
| Total BEIF operating expenses | 439,017 | 602,891 | 1,041,908 |
| Net income | $ – | $ – | $ – |

**Statement of Cash Flows**

| | Region 6 | Region 9 | Total |
|---|---|---|---|
| **Operating activities** | | | |
| Net income | $ – | $ – | $ – |
| Net cash provided by operating activities | – | – | – |
| **Financing activities** | | | |
| Grant funds – EPA | 10,262,624 | 5,409,406 | 15,672,030 |
| Grant disbursements – EPA | (10,262,625) | (5,409,410) | (15,672,035) |
| Net cash provided by financing activities | (1) | (4) | (5) |
| Net decrease in cash and cash equivalents | (1) | (4) | (5) |
| Cash and cash equivalents at January 1, 2014 | 501 | 504 | 1,005 |
| Cash and cash equivalents at December 31, 2014 | $ 500 | $ 500 | $ 1,000 |

*Region 6: EPA Regional Office located in Dallas, Texas*

*Region 9: EPA Regional Office located in San Francisco, California*

A publication of the North American Development Bank ®
Office Responsible for publication: Department of Public Affairs

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4TH DISTRICT, WISCONSIN

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MONETARY POLICY AND TRADE, RANKING MEMBER

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# Congress of the United States
## House of Representatives

April 12, 2016

Dr. Jim Yong Kim
President
The World Bank Group
1818 H Street NW
Washington, D.C. 20433

Re: International Finance Corporation Conflicts of Interest Policy

Dear President Kim:

I write to express my concern that the International Finance Corporation (IFC) is not adequately monitoring and managing the conflicts of interest created when it takes an equity stake in water corporations where it also acted as a water sector adviser. As the Ranking Member of the Monetary Policy and Trade Subcommittee of the House Financial Services Committee, which is tasked with oversight of the World Bank Group (WBG), I am increasingly uneasy with water resource privatization in developing countries and do not believe that the current ring-fencing policies separating the investment and advising functions of the IFC are adequate. I would respectfully urge the WBG and IFC to cease promoting and funding privatization of water resources, including so-called "public-private partnerships" (PPPs) in the water sector, until there has been a robust outside evaluation of the IFC's conflicts policy and practices and an opportunity for additional congressional hearings on the subject.

When the IFC was first established in 1956, it was prohibited from purchasing corporate equity to avoid conflicts of interest. However, in 1961, the IFC's Articles of Agreement were amended with a provision that permitted equity financing.[1] The IFC maintains that the conflicts are managed by a "Chinese wall" that prohibits "its advisory services from sharing information with its lending arm."[2] Therefore, I am alarmed by IFC reports that claim it has "aligned," "combine[d]," or "integrated" its investments and advisory services ("buy side" and "sell side").[3] This suggests to me that the "Chinese wall" is not adequately mitigating the conflict between the IFC's advisory and financing activities. In fact, a water

[1] *Articles of Agreement, Article III - Operations*, INT'L FIN. CORP., http://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/about+ifc_new/ifc+governance/articles/about+ifc+-+ifc+articles+of+agreement+-+article+iii (last modified June 27, 2012).
[2] Stella Dawson, *Activists Urge World Bank to Disinvest from Private Water Companies*, THOMPSON REUTERS FOUNDATION (October 3, 2104, 12:54 GMT), http://news.trust.org/item/20131003125451-xompv.
[3] INT. FIN. CORP., IFC ANNUAL REPORT 2014 (2014), http://www.ifc.org/wps/wcm/connect/0edb7a004572ddb38bb6bb9916182e35/AR2014_Report.pdf?MOD=AJPERES; *IFC, Partner of Municipalities for a Successfull [sic] Introduction of the Private Sector in Waste Management Services*, INT. FIN. CORP. (April 2015), http://www.slideshare.net/NALED/capital-summit-2015-ifc-partner-of-municipalities-for-a-successfull-introduction-of-the-private-sector-in-waste-management-services (Capital Summit 2015, Belgrade).



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privatization arrangement in Manila, Philippines, (where the IFC was both adviser and investor) has resulted in a contentious dispute between an IFC investee corporation and the Philippines government over utility rates and corporate profits deemed excessive by Philippine regulators and international arbitrators.

In the late 1990s, the IFC advised on and facilitated the large-scale privatization of Manila's water system. This ultimately led to the creation of two private corporations in 1997, Manila Water Company (MWC) and Maynilad. The IFC-brokered arrangement seemingly favored MWC, as that corporation took only 10 percent of the pre-existing utility's debt and assumed the service area with better existing infrastructure.[4] The IFC then took an equity stake in MWC only.[5] MWC raised rates by 845 percent,[6] eventually leading to Manila's regulatory body rejecting another rate increase.[7] MWC responded to the rejection of the rate increase by bringing the Manila regulator into arbitration at the International Chamber of Commerce (ICC).[8] The ICC arbitration panel rejected MWC's rate hike, but MWC filed another arbitration case at the Permanent Court of Arbitration in Singapore and petitioned the Philippines' Department of Finance for financial remediation for lost profits.[9] As part-owner of MWC, the IFC is now aligned with MWC and its aggressive pursuit of arbitration to charge utility rates that support levels of compensation exceeding the maximum 12 percent rate of return legal for Philippine utilities.[10]

I would be less troubled with the structure of the Manila deal and the subsequent arbitration if I had full confidence that both were not products of the improper mingling of the advisory and investment functions. As a strong believer in the mission of the World Bank, I have become increasingly concerned that its role as adviser and investor in the MWC deal may now be creating reputational risk for the WBG as the MWC aggressively positions itself at odds with the people and government of the Philippines.

The implications of this conflict of interest go beyond Manila, as the IFC has promoted the Manila case as a flagship model to be emulated around the world,[11] including in Africa,[12] where it has led to IFC

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[4] Jude Esguerra, *The Corporate Muddle of Manila's Water Concessions: How Rules, New Roles: Does PSP Benefit the Poor?* WATERAID & TEARFUND (2003), http://www.wateraid.org/documents/plugin_documents/pspmanila.pdf; INT'L FIN. CORP., SUMMARY OF PROJECT INFORMATION, PROJECT NUMBER 11232, IFC Projects Database, http://ifcext.ifc.org/ifcext/spiwebsite1.nsf/2bc34f011b50ff6e85256a550073ff1c/710a2eb406002edc852576ba000c23c4?opendocument (last visited March 24, 2016).

[5] INT'L FIN. CORP., SUMMARY OF PROJECT INFORMATION, PROJECT NUMBER 25321, IFC Projects Database, http://ifcext.ifc.org/ifcext/spiwebsite1.nsf/2bc34f011b50ff6e85256a550073ff1c/050652ac3b2056c3852576c10080cd0b?opendocument (last visited March 24, 2016); INT'L FIN. CORP., SUMMARY OF PROJECT INFORMATION, PROJECT NUMBER 22621, IFC Projects Database, http://ifcext.ifc.org/ifcext/spiwebsite1.nsf/2bc34f011b50ff6e85256a550073ff1c/8c26a1534a226766852576ba000e25cf?opendocument (last visited March 24, 2016).

[6] House of Representatives, Republic of the Philippines, "House Resolution 109: A Resolution Directing the House Committees on Oversight and Government Enterprises and Privatization to Initiate a Comprehensive Review and Investigation into the Metropolitan Waterworks And Sewerage System (MWSS) Contracts of Water Concessionaires Maynilad Water Services Inc. and Manila Waters Inc. and Make Immediate Recommendations to Address the Current Water Shortage," July 28, 2010, http://www.anakpawis.net/wp-content/plugins/downloads-manager/upload/HR%20109%20-%20review%20of%20MWSS%20contracts.pdf.

[7] *In Re: Rate Rebasing Determination for Manila Water Company, Inc. for Charging Years 2013-2017; Resolution No. 13-009-CA*, 2013.

[8] *Manila Water Concession Agreement*, PUBLIC-PRIVATE PARTNERSHIP IN INFRASTRUCTURE RESOURCE CENTER (1997), http://ppp.worldbank.org/public-private-partnership/library/manila-water-concession-agreement; Euan Paulo C. Añonuevo, *Manila Water Files Dispute with MWSS before Int'l Body*, INTERAKSYON (Sept. 24, 2013, 2:27 PM), http://interaksyon.com/business/71403/manila-water-files-dispute-with-mwss-before-intl-body.

[9] *Manila Water Seeks P79B Compensation from Gov't*, RAPPLER (April 24, 2015, 9:26 AM), http://www.rappler.com/business/industries/90966-manila-water-seeks-compensation-ph-government; *Manila Water Presses for Indemnity*, BUSINESS WORLD ONLINE (Dec. 10, 2015, 11:27:00 PM), http://www.bworldonline.com/content.php?section=TopStory&title=manila-water-presses-for-indemnity&id=120063.

[10] Manila Electric Company v. Public Service Commission, 18 SCRA 651, 665-666 (1966).

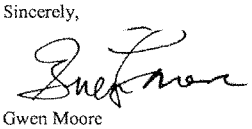
[11] INT'L FIN. CORP., PUBLIC-PRIVATE PARTNERSHIP STORIES: PHILIPPINES: MANILA WATER (2010), http://www.ifc.org/wps/wcm/connect/3f64d180498391a5856cd7336b93d75f/PPPStories_Philippines_ManilaWater.pdf?MOD=AJPERES.

[12] *Accelerating Access to Water and Sanitation in Sub-Saharan Africa: Scaling Up Private Sector Participation*, WATER AND SANITATION PROGRAM, http://www.wsp.org/FeaturesEvents/Calendar/accelerating-access-water-and-sanitation-sub-saharan-africa (last visited April 5, 2016). Note: direct, easily

advisory contracts in Benin and Mozambique[13] and informed a widely opposed privatization scheme in Lagos, Nigeria.[14] MWC, with IFC support, has expanded internationally, with a growth focus in Vietnam, Indonesia, and other regional markets. It is therefore important that the WBG address my concerns and take a renewed evaluation and analysis of its conflicts policy. For these reasons, I would urge the WBG, including the IFC, to cease promoting privatization of water resources until there has been a robust outside evaluation of the IFC conflicts policy and practices.

I appreciate your attention to this issue and look forward to hearing back from you.

Sincerely,



Gwen Moore
Ranking Member
House Financial Services Subcommittee on Monetary Policy and Trade

Cc:
Philippe Le Houérou
Executive Vice President and CEO
International Finance Corporation
2121 Pennsylvania Avenue NW
Washington, D.C. 20433

The Honorable Jacob Lew
Secretary of the Treasury
U.S. Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

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navigable link to explicit promotion of the Manila case at the Dakar conference has since been removed, but PDFs and further evidence are available upon request.

[13] INT'L FIN. CORP., BENIN WATER SYSTEMS: SUMMARY OF ADVISORY SERVICES PROJECT INFORMATION, IFC Projects Database, https://ifcendd.ifc.org/ifcext/spiwebsite1.nsf/d011bd56046289dc85257b6000260169/ac14bbf648c9722185257c680069e471?opendocument (last visited March 24, 2016); INT'L FIN. CORP., MOZAMBIQUE WATER TRANSACTION ADVISORY, SUMMARY OF ADVISORY SERVICES PROJECT INFORMATION, IFC Projects Database, https://ifcendd.ifc.org/ifcext/spiwebsite1.nsf/d011bd56046289dc85257b6000260169/451eb062c0d49e7b85257bc1005ec69e?opendocument (last visited March 24, 2016).

[14] John Vidal, *Water Privatisation: A Worldwide Failure?*, THE GUARDIAN (Jan. 30, 2015), http://www.theguardian.com/global-development/2015/jan/30/-water-privatisation-worldwide-failure-lagos-world-bank; Adeola Akinremi, *Nigeria: U.S. Congressional Black Caucus Expresses Concern Over Water Privatisation in Lagos*," ALL AFRICA (June 18, 2015), http://allafrica.com/stories/201506181172.html.