STANDARD & POOR'S

# Company Credit Report

***Credit Ratings***

AA-/Stable/A-1+

***Primary Credit Analysts***:
Larry Hays
Ph.D.
New York
(1) 212-438-7347
larry_hays@
standardandpoors.com

***Secondary Credit Analysts***:
John Chambers
CFA
New York
(1) 212-438-7344
john_chambers@
standardandpoors.com

***RatingsDirect***
***Publication Date***
July 20, 2006

# Inter-American Investment Corporation

## Major Rating Factors

***Strengths:***

- A strong capital position, the result of relatively large, ongoing capital contributions from most of its shareholders;
- An important policy purpose: to support the growth and development of small and midsize enterprises (SMEs) in Latin American and Caribbean member countries (LACMCs);
- Membership in and support from the Inter-American Development Bank (IADB; 'AAA' [all institutional ratings herein are long-term issuer credit ratings]) group; and
- Ample liquidity.

***Weaknesses:***

- The most challenging mandate of any rated multilateral development finance institution (MDFI);
- Small size, which has limited the corporation's impact on economic growth and development and, consequently, its franchise value; and
- Failure of some of its members, including its largest members, to pay their scheduled capital contributions on time.

## Rationale

Inter-American Investment Corp. (IIC) began operations in 1989 with a mandate to finance the establishment, expansion, and modernization of SMEs by providing equity and short-, medium-, and long-term loans without government guarantees; by mobilizing funding from other investors; and by providing a variety of financial and technical advisory services. Its membership includes all IADB LACMCs and all but four nonregional members.

IIC is the smallest of the rated MDFIs in terms of both assets and shareholders' equity. Its total assets at year-end 2005 were US$676 million, of which US$432 million was loans and US$78 million was equity investments. Its shareholders' equity was US$469 million.

The corporation's difficult mandate contributed to loan and equity portfolios that performed poorly for many years, resulting in an accumulated deficit of almost US$32 million at year-end 2005. IIC's financial performance has improved substantially in recent years, with net income of US$13.7 million during 2005.

In December 1999, IIC's members approved an increase in IIC's authorized capital to US$703.7 million from US$203.7 million, of which US$700.7 million was subscribed as of year-end 2005. Subscriptions from the 1999 capital increase are payable in eight roughly equal installments beginning in 2000 and ending in 2007. Combined with the relatively slow growth of its loans, equity investments, and guarantees (together, its development-related exposure [DRE]), these installments of paid-in capital resulted in an increasingly strong financial profile. At year-end 2005, IIC's ratio of provisions for losses plus shareholders' equity (its narrow risk-bearing capacity) to DRE was 102%, among the highest for rated MDFIs.

IIC had nearly US$208 million in cash and marketable securities at year-end 2005. With only US$130 million in outstanding borrowings from committed facilities totaling US$530 million (including US$300 million from IADB)—the first US$30 million of which is payable in 2009—and scheduled additional receipts of paid-in capital of almost US$200 million during 2006 and 2007, IIC has a very strong liquidity position.

The corporation's mandate has proven challenging, if not daunting. Its shareholders have relaxed some of the strictures under which it has operated and IIC's management has changed some of its policies and practices, which should result in better-performing loan and equity portfolios in the future. Nonetheless, in the absence of additional capital, IIC will continue to suffer diseconomies of scale and be frustrated in its efforts to have a measurable impact on development in its LACMCs.

## Outlook

The stable outlook balances IIC's difficult mandate, the prospect of the end of members' capital contributions in 2007, its lack of support from some of its member countries, and the prospect that it will continue to have a small developmental impact against its strong capital and liquidity positions and improved financial performance.

## Membership And Voting Power

IIC came into formal existence in 1986 and had 34 member countries at year-end 1988. All 26 of IADB's LACMCs were members by year-end 1999, and only four of IADB's 21 nonregional members had not joined by year-end 2005: Canada ('AAA'; all country ratings are long-term foreign currency sovereign ratings as of June 30, 2006), the U.K. ('AAA'), and the Republics of Croatia ('BBB') and Slovenia ('AA').

LACMCs had subscribed to 53.7% of total subscribed shares as of year-end 2005; the U.S. ('AAA'), 25.1%; and the 15 nonregional countries, 21.1%. Each member has one vote for each fully paid share it holds. Although decisions are usually made by a majority of the votes cast, qualified majorities are required for some decisions. For example, at least 75% of the votes, including those of two-thirds of the governors, are necessary to authorize a major capital increase, and 80% are required to amend the agreement—again including those of two-thirds of the governors.

## Governance And Organization

Under the agreement establishing IIC, each country appoints a governor—usually its minister of finance—to IIC's board of governors. These are typically the governors of IADB. The chairman of the board of governors of IADB also serves as the chairman of IIC's board of governors. The board of governors delegates all but a list of specified powers to IIC's board of executive directors.

IIC's 13 executive directors are typically appointed or elected from among IADB's executive directors or alternates, although this need not be the case. The U.S. appoints one executive director by virtue of its being the largest single shareholder, nine executive directors are elected by governors of the LACMCs, and three executive directors are elected by governors of the nonregional member countries.

IADB's president is ex-officio chairman of the board of executive directors. A general manager is appointed by the board of executive directors to serve as chief executive officer. The current general manager, Mr. Jacques Rogozinski, took office in January 2000; he was confirmed for a second five-year term in January 2005.

IIC's staff has always been small, having peaked at about 115 in the early 1990s. At year-end 2005, IIC had a headcount of 98. Of these positions, 76 were Washington, D.C., based (53 professionals, 11 administrative, and 12 consultants), and 22 (19 professionals and three administrative) were in IIC's regional offices in Santiago, Republic of Chile ('A'); Bogotá, Republic of Colombia ('BB'); San Jose, Republic of Costa Rica ('BB'); Asuncion, Republic of Paraguay ('B'); Montevideo, Republic of Uruguay ('B'); Tegucigalpa, Republic of Honduras (not rated); and Managua, Republic of Nicaragua (not rated). Of the Washington, D.C., based professional positions, 16 are dedicated to originating and developing new projects and four to portfolio supervision.

Only modest additional increases in staffing are expected during the next several years because management intends to leverage its staff more effectively than in the past. As part of this effort, staff members will likely continue to be reallocated to IIC's offices in regional member countries.

IIC's relationship with IADB extends well beyond the previously mentioned formal links. For instance, IIC obtains some administrative and overhead services from IADB, including the sharing of facilities for its overseas offices. It also coordinates with IADB in the development of the private sector segments of LACMC strategies and programming and receives a large committed credit facility from IADB. Finally, IADB's president has, on occasion, intervened with member governments to ensure IIC's preferred creditor treatment.

## Balance Sheet

Table 1 summarizes IIC's balance sheet. The most notable features are:

- Its small size. Total assets were US$676 million and shareholders' equity was US$469 million at year-end 2005, making it the smallest of rated MDFIs;
- The rapid growth in its loans during 2005, after the much more modest growth in preceding years;
- The rapid growth in its paid-in capital, which averaged 15.6% per year over the preceding four years;
- Its relatively modest liabilities, which were US$207 million at year-end 2005; and
- Its accumulated deficit in retained earnings, which fell to US$32 million at year-end 2005 from a high of US$51 million at year-end 2002.

Table 1

**IIC Balance Sheet**

| | —Year ended Dec. 31— | | | | |
|---|---|---|---|---|---|
| **(Mil. US$)** | **2005** | **2004** | **2003** | **2002** | **2001** |
| ***Assets*** | | | | | |
| Cash and cash equivalents | 49 | 64 | 19 | 20 | 4 |
| Marketable securities | 158 | 46 | 66 | 58 | 50 |
| Loan investments | 432 | 342 | 306 | 269 | 275 |
| Reserve for loan losses | (48) | (45) | (45) | (46) | (30) |
| Equity investments | 78 | 101 | 112 | 114 | 101 |
| Reserve for losses on equity investments | (9) | (31) | (41) | (41) | (27) |
| Mortgage-backed securities | 0 | 0 | 0 | 5 | 4 |
| Receivables and other assets | 15 | 11 | 9 | 7 | 4 |
| Total assets | 676 | 487 | 426 | 385 | 381 |
| ***Liabilities*** | | | | | |
| Accounts payable and other liabilities | 11 | 9 | 7 | 18 | 6 |
| Borrowings | 196 | 80 | 80 | 85 | 105 |
| Total liabilities | 207 | 89 | 87 | 103 | 111 |
| ***Capital*** | | | | | |
| Paid-in capital | 501 | 444 | 388 | 333 | 280 |
| Retained earnings/(accumulated deficit) | (32) | (45) | (49) | (51) | (10) |
| Total shareholders' equity | 469 | 399 | 340 | 282 | 270 |

## Risk

For risk-assessment purposes, IIC's activities may be broken into treasury activities—which result in holdings of cash and investments as well as borrowings—and development-related activities—which result in loans, equity investments, and guarantees.

### *Treasury activities*

Like most other MDFIs, IIC does not view its treasury activities as a major source of income for the corporation. Rather, they are intended to fund the corporation and to hold adequate liquidity in a conservative yet cost-effective manner.

Treasury credit risk.

IIC's policies require it to place its cash and deposits with highly rated banks. Its marketable securities are sovereign, agency, bank, or corporate obligations rated 'AA' or better and asset-backed securities rated 'AAA'.

Interest rate risk.

To date, the majority of IIC's loans and borrowings have been floating rate, minimizing the risk from interest-rate mismatches on the portion of the loan portfolio funded by borrowings, which are also predominantly floating rate. However, most of IIC's loans (and other assets) are funded by its capital. Accordingly, income from loans reflects changes in the level of interest rates, declining when rates fall and increasing when they rise. To weaken this link, IIC has begun making fixed-rate loans and is creating a fixed-rate, hold-to-maturity treasury portfolio Exchange-rate risk.

All of IIC's capital and borrowings as well as virtually all of its loans and other financial assets traditionally have been denominated in U.S. dollars. In December 2005, the corporation issued approximately US$66 million in Colombian peso bonds; however, the proceeds were immediately disbursed in pesos to provide financing for SMEs in Colombia. Accordingly, the risk of loss arising directly from exchange-rate changes is minimal.

In sum, the risk arising from IIC's treasury activities is very limited, particularly relative to the corporation's risk-bearing capacity.

***Development-related activities***

IIC operates in what have sometimes been difficult economic environments. At year-end 2005, only three of 19 countries where IIC had DRE were rated investment grade by Standard & Poor's Ratings Services, and only 11% of IIC's loans identified by country were to borrowers domiciled in these countries. The countries in which IIC had loans and especially equity investments is obscured because at year-end 2005 7% of loans and 61% of equity investments were classified as regional.

Compounding the effects of the difficult economic environments in which most of IIC's private sector clients operate is its mandate to give preferential support to SMEs. IIC's focus on SMEs is operationalized through the use of three criteria to measure size: assets, sales, and employees. Enterprises are classified in the smallest category for which two of the size criteria are satisfied. IIC's size standards are shown in table 2.

Table 2

**IIC Client Size Criteria**

| *Enterprise* | *Assets (Mil. US$)* | *Sales (Mil. US$)* | *Employees* |
|---|---|---|---|
| Small | Less than 10 | Less than 10 | Fewer than 250 |
| Medium | 10-35 | 10-35 | 250-750 |
| Large | More than 35 | More than 35 | More than 750 |

IIC's board of executive directors has recognized the difficulty in lending only to SMEs, and in 2003 it authorized a two-year program under which the corporation can submit up to 33% of cumulative project approvals for larger companies (those with annual sales or assets of up to US$150 million). A three-year extension of the program (until 2007) was approved in June 2004.

In addition to targeting private sector enterprises, IIC's agreement also provides that "enterprises with partial share participation by government or other public entities, whose activities strengthen the private sector of the economy, are eligible for financing by the Corporation."

Lending by industry.

IIC has wide scope for its financing, consistent with its focus on SMEs. Table 3 shows IIC's lending by industrial sector. That most of IIC's lending at year-end 2005 was to the financial services sector reflects its practice of providing much of its financing to smaller borrowers through local financial institutions. This has the effect of both enabling IIC to more efficiently reach its smallest borrowers and enhancing the quality of its loan portfolio, since IIC takes the credit risk of the financial institution under this arrangement.

Table 3

| IIC Loans, By Sector (cont.'d) | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | — Year ended Dec. 31— | | | | | | | | | |
| | 2005 | | 2004 | | 2003 | | 2002 | | 2001 | |
| | Mil. US$ | Total (%) | Mil. US$ | Total (%) | Mil. US$ | Total (%) | Mil. US$ | Total (%) | Mil. US$ | Total (%) |
| Financial services | 245 | 56.7 | 151 | 44.1 | 131 | 42.8 | 111 | 41.4 | 143 | 52.1 |
| Agriculture and agribusiness | 47 | 11.0 | 33 | 9.8 | 34 | 11.1 | 19 | 7.2 | 14 | 5.0 |
| Aquaculture and fisheries | 20 | 4.7 | 24 | 6.9 | 20 | 6.7 | 20 | 7.5 | 4 | 1.3 |
| Utilities and infrastructure | 17 | 4.0 | 17 | 4.8 | 20 | 6.5 | 20 | 7.3 | 18 | 6.7 |
| Education | 14 | 3.2 | 15 | 4.5 | 10 | 3.4 | 1 | 0.4 | 0 | 0.0 |
| Chemicals and plastics | 13 | 2.9 | 6 | 1.8 | 8 | 2.8 | 13 | 4.9 | 7 | 2.6 |
| Wood, pulp, and paper | 13 | 2.9 | 15 | 4.3 | 12 | 3.8 | 10 | 3.8 | 2 | 0.7 |
| Livestock and poultry | 11 | 2.6 | 8 | 2.3 | 0 | 0.0 | 0.0 | 0.0 | 0 | 0 |
| General manufacturing | 10 | 2.4 | 15 | 4.5 | 12 | 4.0 | 11 | 3.9 | 13 | 4.8 |
| Food, bottling, and beverages | 9 | 2.2 | 10 | 3.0 | 7 | 2.2 | 9 | 3.4 | 12 | 4.2 |
| Industrial processing zones | 8 | 1.8 | 9 | 2.7 | 6 | 2.0 | 8 | 2.8 | 9 | 3.1 |
| Tourism and hotels | 7 | 1.7 | 9 | 2.6 | 13 | 4.1 | 11 | 4.2 | 17 | 6.1 |
| Textiles, apparel, and leather | 4 | 1.0 | 6 | 1.8 | 3 | 1.0 | 5 | 1.7 | 6 | 2.1 |
| Transportation and warehousing | 4 | 0.9 | 14 | 4.1 | 15 | 4.9 | 15 | 5.6 | 15 | 5.3 |
| Other | 8 | 1.9 | 10 | 2.8 | 15 | 4.8 | 16 | 6.0 | 16 | 6.0 |
| Total | 432 | 100.0 | 342 | 100.0 | 306 | 100.0 | 269 | 100.0 | 275 | 100.0 |

**Loan pricing.**

IIC's loan pricing is generally 100 basis points-600 basis points over one-, three-, or six-month LIBOR. Spreads are based upon the cost of recent sovereign syndicated loans to the borrower's country of domicile (or to a similarly rated country if no loan to that country has been made recently) plus an additional spread to compensate for the individual borrower's risk and the illiquidity of the loan.

**Loan maturities.**

Historically, IIC has concentrated on medium- and long-term lending, with maturities typically falling in the five-to-eight-year range, with a maximum of 12 years. In 2003, IIC began making short-term loans, with tenors of one to two years, for working capital and export finance purposes. Such loans meet a pressing need for many of IIC's SME clients, and they tend to improve the quality of its loan portfolio. There appears to have been a modest shortening in the maturity profile of IIC's loans in recent years. At year-end 2005, 6.5% of IIC's outstanding loans had final maturities of more than five years, while 20.5% had final maturities of one year or less.

**Equity investments.**

Table 4 shows IIC's equity investments by industrial sector. IIC's founders were hopeful that equity investments would constitute a major portion of its assets—in the form of either direct investments or holdings in private equity funds targeted at LACMCs. In practice, IIC's equity investments have been smaller than had been expected—and in recent years have been falling not only relative to loans, but in absolute terms as well. Gross equity investments were 15% of DRE at year-end 2005, down from almost 30% at year-end 2002. Disbursements for equity investments totaled US$4.1 million in 2005, compared to US$183 million for loans, and receipts from sales of equity investments totaled US$8.8 million. IIC has moved away from direct investments and increasingly focused its equity investments on funds of one type or another.

Table 4

**IIC Equity Investments, By Sector**

| | —Year ended Dec. 31— | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | | 2004 | | 2003 | | 2002 | | 2001 | |
| | Mil. US$ | Total (%) | Mil. US$ | Total (%) | Mil. US$ | Total (%) | Mil. US$ | Total (%) | Mil. US$ | Total (%) |
| Venture capital funds | 55 | 70.6 | 76 | 75.2 | 87 | 77.1 | 87 | 76.0 | 82 | 81.6 |
| Financial services | 23 | 29.4 | 23 | 22.8 | 23 | 20.7 | 21 | 18.6 | 10 | 10.4 |
| Agriculture and agribusiness | 0 | 0.0 | 2 | 2.0 | 2 | 1.8 | 2 | 1.8 | 2 | 2.0 |
| Acquaculture and fisheries | 0 | 0.0 | 0 | 0.0 | 0 | 0.4 | 4 | 3.6 | 4 | 4.1 |
| Food, bottling, and beverages | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 2 | 2.0 |
| Total | 78 | 100.0 | 101 | 100.0 | 112 | 100.0 | 114 | 100.0 | 101 | 100.0 |
| ***Memo item:*** | | | | | | | | | | |
| Regional equity funds | 48 | 61.4 | 60 | 59.7 | 73 | 64.9 | 70 | 61.5 | 56 | 55.6 |

**Total loan and equity limits.**

IIC does not have specific limits on its total loans. However, the sum of disbursed and committed-but-undisbursed loans and guarantees, equity investments, and LACMC mortgaged-backed securities is limited to 400% of IIC's shareholders' equity. At year-end 2005, this percentage was 123%, implying that, in principle, the corporation has huge leeway to increase its DRE.

The corporation has a sublimit of 100% of shareholders' equity for the sum of its equity and quasi-equity investments. However, in practice, such investments have been limited to 66% of shareholders' equity. Disbursed equity and quasi-equity investments totaled US$78 million at year-end 2005 (US$23 million in direct and quasi-equity investments and US$55 million in private equity and venture capital funds) against shareholders' equity of more than US$469 million.

**Investment concentration.**

IIC's policies limiting concentration in its loan and equity investment portfolios include:

- Country concentration limit. The higher of either 15% of the net active approved portfolio of loans and equity (US$122 million at year-end 2005) or 15% of shareholders' equity (US$70 million). IIC's largest country exposure at year-end 2005 was US$92 million to Colombia, followed by US$85 million to the Federative Republic of Brazil ('BB'). By contrast, at year-end 1999, IIC had more than US$80 million in exposure to the Republic of Argentina ('B'), which was nearly 39% of shareholders' equity (see table 5). This dropped to US$57 million (21% of shareholders' equity) by year-end 2001, when Argentina's financial crisis was underway, and fell further to US$21 million (4% of shareholders' equity) by year-end 2005. The growing diversification in IIC's country exposures in recent years reversed in 2004, primarily because of the sharp increase in IIC's exposure in Brazil, and fell further during 2005 as a result of large increases in exposure in Colombia and Brazil.

Table 5

**IIC Loan And Equity Concentration**

| | —Year ended Dec. 31— | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2005 | | 2004 | | 2003 | | 2002 | | 2001 | |
| | Mil. US$ | Total (%) | Mil. US$ | Total (%) | Mil. US$ | Total (%) | Mil. US$ | Total (%) | Mil. US$ | Total (%) |
| Regional | 79 | 15.5 | 83 | 18.7 | 81 | 19.3 | 74 | 19.4 | 59 | 15.8 |
| Colombia | 92 | 18.0 | 19 | 4.4 | 23 | 5.6 | 15 | 3.8 | 7 | 2.0 |
| Brazil | 85 | 16.7 | 64 | 14.4 | 38 | 9.2 | 34 | 8.8 | 31 | 8.1 |
| Chile | 44 | 8.6 | 44 | 9.9 | 47 | 11.1 | 37 | 9.7 | 25 | 6.7 |
| Mexico | 29 | 5.7 | 34 | 7.7 | 35 | 8.5 | 30 | 7.8 | 26 | 6.8 |
| Argentina | 21 | 4.0 | 27 | 6.2 | 36 | 8.7 | 42 | 11.0 | 57 | 15.2 |
| Peru | 20 | 4.0 | 27 | 6.1 | 24 | 5.7 | 16 | 4.2 | 17 | 4.5 |
| Uruguay | 20 | 4.0 | 14 | 3.1 | 7 | 1.6 | 7 | 1.8 | 6 | 1.7 |
| Costa Rica | 18 | 3.5 | 21 | 4.8 | 17 | 4.2 | 18 | 4.6 | 22 | 5.9 |
| Nicaragua | 17 | 3.4 | 10 | 2.3 | 15 | 3.5 | 15 | 3.9 | 13 | 3.5 |
| Honduras | 12 | 2.4 | 16 | 3.5 | 12 | 2.9 | 14 | 3.7 | 16 | 4.2 |
| Venezuela | 12 | 2.3 | 15 | 3.3 | 16 | 3.9 | 16 | 4.2 | 10 | 2.6 |
| El Salvador | 11 | 2.1 | 10 | 2.2 | 1 | 0.3 | 0 | 0.0 | 2 | 0.5 |
| Bolivia | 9 | 1.8 | 9 | 1.9 | 6 | 1.4 | 13 | 3.4 | 26 | 7.0 |
| Panama | 7 | 1.3 | 17 | 3.9 | 20 | 4.7 | 10 | 2.7 | 9 | 2.5 |
| Paraguay | 5 | 1.0 | 5 | 1.1 | 6 | 1.4 | 8 | 2.1 | 11 | 3.0 |
| Jamaica | 3 | 0.5 | 3 | 0.8 | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Trinidad & Tobago | 1 | 0.1 | 2 | 0.4 | 2 | 0.6 | 3 | 0.8 | 4 | 1.1 |
| Guatemala | 0 | 0.1 | 4 | 1.0 | 7 | 1.6 | 9 | 2.4 | 15 | 4.0 |
| Belize | 0 | 0.0 | 1 | 0.2 | 1 | 0.2 | 1 | 0.3 | 0 | 0.0 |
| Dominican Republic | 0 | 0.0 | 0 | 0.0 | 7 | 1.6 | 15 | 4.0 | 17 | 4.5 |
| Bahamas | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 | 0 | 0.1 | 0 | 0.1 |
| Ecuador | | 0.0 | 18 | 4.1 | 17 | 4.1 | 6 | 1.5 | 1 | 0.3 |
| Balance sheet total | 511 | 100.0 | 443 | 100.0 | 419 | 100.0 | 383 | 100.0 | 376 | 100.0 |
| ***Country exposure concentration*** | | | | | | | | | | |
| Largest country exposure | 92 | 18.0 | 64 | 14.4 | 47 | 11.1 | 42 | 11.0 | 57 | 15.2 |
| Two largest exposures | 177 | 34.7 | 108 | 24.3 | 85 | 20.3 | 79 | 20.6 | 88 | 23.3 |
| Three largest exposures | 221 | 43.3 | 142 | 32.0 | 121 | 28.9 | 113 | 29.4 | 114 | 30.3 |
| Four largest exposures | 250 | 49.0 | 169 | 38.2 | 157 | 37.4 | 142 | 37.2 | 140 | 37.1 |
| Five largest exposures | 271 | 53.0 | 196 | 44.3 | 180 | 43.1 | 160 | 41.8 | 165 | 43.8 |

Sector concentration. The higher of either 10% of the total net active approved portfolio or 10% of shareholders' equity (except for financial institutions, for which the limit is 40%).

- Company concentration. IIC's financing of any one project is subject to two different types of constraints. First, IIC will generally finance no more than 33% of any single project's investment cost (except for expansion projects, where it may finance as much as 50%). Second, its total financing per company can be no more than either 5% of IIC's total portfolio or 5% of shareholders' equity, whichever is higher.

- **Equity-investment concentration**. IIC's share of the total paid-in capital in any company is limited to 33%. The sum of equity and quasi-equity investments in any company is limited to 3% of IIC's shareholders' equity, and total exposure is limited to 5% of IIC's shareholders' equity.

With the exception of its exposure to financial institutions, IIC has operated well within its guidelines in recent years.

**Nonaccrual and arrears policies**.

IIC policies call for it to classify a loan as nonaccrual when payments are 60 days past due; however, in practice the classification is often earlier. Loans past due 90 days or more must be classified as nonaccrual. Disbursements of loans will ordinarily be suspended when payments of principal, interest, or fees are 60 days past due, although management may suspend disbursements earlier if warranted.

**Loan portfolio quality.**

All of IIC's loans are to private sector or quasi-public sector entities, none carry sovereign guarantees, and recipients of these loans have been predominantly SMEs, most of them operating in difficult economic environments. These factors result in a level of embedded credit risk in IIC's loan portfolio that is much higher than that found in other MDFIs. Moreover, in 2001-2003, the economic conditions under which many of IIC's clients operated deteriorated sharply, although conditions have improved since that time. Table 6 documents this in the index of country economic conditions. This index is calculated by determining the percentage of IIC's loans and equity investments in each member country, grouping these percentages by the ratings on the countries, and applying a default rate to each of these percentages. The result is a weighted-average default rate, which is the index. The higher the index number, the more stressful the economic conditions. This index number increased to 13.2 at year-end 2001 from 8.6 at year-end 2000, chiefly as the result of Argentina's slide into default, slowly improved to 10.1 at year-end 2004, then fell sharply to 8.3 at year-end 2005.

From 2000 to 2002, IIC's impaired and nonaccrual loans increased sharply, interest collection rates fell to less than 80%, and loan write-offs as a percentage of loans outstanding at the previous year end reached 5.5%. Improvements began during 2003 and all metrics of portfolio performance were markedly better at year-end 2005 than four years earlier. As a consequence, the allowance for loan losses relative to impaired and nonaccrual loans was the highest in recent years. In the past, IIC did not always adequately provision its loans on an ongoing basis, resulting in volatile provisioning and net income. However, it has revamped its procedures for determining appropriate loan-loss provisions, and Standard & Poor's expects these to be more stable in the future.

Table 6

**IIC Loan Portfolio Quality Indicators And Provisions**

| | —Year ended Dec. 31— | | | | |
|---|---|---|---|---|---|
| ***(Mil. US$, unless otherwise indicated)*** | ***2005*** | ***2004*** | ***2003*** | ***2002*** | ***2001*** |
| ***Distribution of development-related exposure by country rating categories (%)*** | | | | | |
| A- and above | 10.3 | 12.0 | 13.8 | 12.1 | 8.1 |
| BBB | 7.9 | 11.1 | 11.2 | 10.7 | 3.2 |
| BB | 53.4 | 44.6 | 27.3 | 26.9 | 46.2 |
| B | 22.7 | 19.8 | 28.2 | 29.7 | 24.0 |
| CCC and below | 5.8 | 12.4 | 19.6 | 20.7 | 18.4 |
| Index of country economic conditions (decrease denotes more favorable conditions) | 8.3 | 10.1 | 12.5 | 12.9 | 13.2 |
| Impaired loans (mil. US$) | 33 | 33 | 43 | 46 | 22 |

Table 6

**IIC Loan Portfolio Quality Indicators And Provisions (cont.'d)**

| | —Year ended Dec. 31— | | | | |
|---|---|---|---|---|---|
| ***(Mil. US$, unless otherwise indicated)*** | ***2005*** | ***2004*** | ***2003*** | ***2002*** | ***2001*** |
| As a % of outstanding loans | 7.6 | 9.5 | 14.2 | 16.9 | 7.9 |
| Nonaccrual loans | 51 | 64 | 52 | 62 | 83 |
| As a % of outstanding loans | 11.8 | 18.8 | 16.9 | 22.8 | 29.8 |
| Interest collection rate (%) | 89.9 | 91.9 | 81.8 | 79.3 | 88.4 |
| Loans written off | 4 | * | 3 | 15 | 6 |
| Loan write-offs as a % of outstanding loans at previous year-end | 1.1 | 0.1 | 1.0 | 5.5 | 2.1 |
| Recoveries of loans previously written off | 2 | 7 | 7 | 1 | * |
| Provision (release of provision) for loan losses | 4 | (6) | (5) | 30 | 11 |
| Reserve for loan losses | 48 | 45 | 45 | 46 | 30 |
| As a % of impaired loans | 145.5 | 139.7 | 104.1 | 98.9 | 137.5 |
| As a % of nonaccrual loans | 93.5 | 70.7 | 87.3 | 73.2 | 36.5 |
| As a % of outstanding loans | 11.0 | 13.3 | 14.8 | 16.7 | 10.9 |
| Equity investments written off | 4 | 20 | 5 | 0.3 | 3 |
| Equity investment write-offs as a % of outstanding equity investments at previous year-end | 3.6 | 17.7 | 4.0 | 0.3 | 3.3 |
| Provision for losses on equity investments | 4 | 9 | 4 | 14 | 14 |
| Reserve for losses on equity investments | 9 | 31 | 41 | 41 | 27 |
| As a % of outstanding equity investments | 12.0 | 30.4 | 36.6 | 36.1 | 26.7 |

*Less than US$0.5 million. ¶Includes mortgage-backed securities at year-ends 2002 and 2001.

IIC's losses on its equity investments have been more severe than those on its loans. However, its allowance for losses on equity investments during the past five years varied from 27% to 61% (at year-end 2005). As a consequence, future losses seem well covered by the allowance.

The corporation has taken various measures to strengthen its credit policies and procedures over the past few years. Policy changes include:

- A reduction in the country-exposure limit to 15% from the former 20%;
- A revised risk rating system, which affects loan pricing and drives the determination of appropriate provisions;
- An increase in the percentage of the loan portfolio that may be lent to financial institutions (which has been relatively low-risk for IIC) to 40% from 30%;
- The ability to lend larger amounts to individual financial institutions, which will strengthen IIC's relationship with larger LACMC financial institutions;
- The authority to make short-term loans for working capital and export finance; and
- The ability to lend limited amounts to larger, less-risky borrowers than were originally contemplated.

IIC has also been tightening up its organizational structure by separating loan origination from loan supervision, fostering both specialization and expertise while aligning responsibility. In addition, it has been successful in more aggressively seeking to realize value from its problem loans, including those it has written off.

The cumulative effect of these changes in policies, procedures, and organization should improve the performance of IIC's loan portfolio. However, as long as most of the main recipients of its loans continue to be SMEs operating primarily in difficult economic environments, portfolio quality will continue to be a fundamental concern.

## Risk-Bearing Capacity And Capital Adequacy

IIC's narrow risk-bearing capacity consists of its allowances for losses and its shareholders' equity; since it has no callable capital, its broad risk-bearing capital is identical to its narrow risk-bearing capital. As shown in table 7, IIC's shareholders' equity at year-end 2005 was US$469 million, having increased at an almost 15% annual rate over the past four years. This increase is entirely the result of increases in paid-in capital, which grew to US$501 million at year-end 2005 from US$280 million at year-end 2001. Retained earnings, already negative at year-end 2001, fell by almost US$22 million over the same period; however, the shortfall began declining beginning in 2003 as a result of increasingly positive earnings, and likely will be eliminated by year-end 2007.

Table 7

**IIC Capital And Capital Adequacy**

| | —Year ended of Dec. 31— | | | | |
|---|---|---|---|---|---|
| ***(Mil. US$, unless otherwise indicated)*** | ***2005*** | ***2004*** | ***2003*** | ***2002*** | ***2001*** |
| Authorized capital | 704 | 704 | 704 | 704 | 704 |
| Subscribed capital | 701 | 696 | 696 | 692 | 682 |
| Subscriptions receivable | (200) | (252) | (308) | (359) | (402) |
| Paid-in capital | 501 | 444 | 388 | 333 | 280 |
| Retained earnings/(accumulated deficit) | (32) | (45) | (49) | (51) | (10) |
| Total shareholders' equity | 469 | 399 | 340 | 282 | 270 |
| Reserve for loan losses | 48 | 45 | 45 | 46 | 30 |
| Reserve for equity losses | 9 | 31 | 41 | 41 | 27 |
| Narrow risk-bearing capacity* | 526 | 475 | 426 | 369 | 328 |
| Total assets | 676 | 487 | 426 | 385 | 381 |
| Total DRE | 516 | 448 | 419 | 383 | 377 |
| Shareholders' equity/total assets (%) | 69.4 | 81.8 | 79.7 | 73.2 | 70.8 |
| Narrow risk-bearing capacity/total assets (%) | 77.9 | 97.4 | 99.9 | 95.7 | 85.9 |
| Narrow risk-bearing capacity/total DRE (%) | 102.0 | 105.9 | 101.7 | 96.3 | 87.0 |
| Memo item: | | | | | |
| Gross loans¶ | 432 | 342 | 306 | 274 | 280 |
| Gross equity investments | 78 | 101 | 112 | 114 | 101 |
| Maximum amount of payments under guarantees | 5 | 5 | 0 | 0 | 0 |
| Total DRE | 516 | 448 | 419 | 388 | 381 |

*Total shareholders' equity plus reserves for loan and equity losses. ¶Includes mortgage-backed securities in 2003 and 2002. DRE-Development-related exposure.

The increases in paid-in capital are pursuant to a December 1999 agreement that authorized a US$500 million increase in IIC's authorized capital, with subscriptions to be paid in roughly equal annual installments beginning in 2000 and ending in October 2007. Nearly US$701 million of total authorized capital of US$704 million—more than 99%—was subscribed at year-end 2005. Nearly US$200 million in capital contributions are scheduled to be received by end-October 2007, although the entire amount may not be received on schedule.

As often happens with capital increases for MDFIs, there have been delays by some members in making payments for IIC's 1999 capital increase. As of April 30, 2006, shortfalls of scheduled contributions by LACMCs totaled more than US$32 million, most of which was owed by IIC's two largest regional shareholders; in addition, the U.S. was delinquent on US$20 million. A number of countries have expressed interest in acquiring additional shares, and IIC's management expects to receive all of the subscribed capital eventually.

As noted above, IIC's paid-in capital currently is not bolstered by retained earnings, as is the case for other MDFIs. However, positive net income is now reinforcing the effects of the paid-in capital contributions.

As table 7 also shows, IIC has historically maintained a strong capital position despite its poor profitability, and this capital position has actually been improving in recent years. IIC's ratio of shareholders' equity to assets increased monotonically to 82% at year-end 2004 from 58% at year-end 2000 before declining to 69% at year-end 2005. More importantly, its ratio of narrow risk-bearing capacity to DRE has exhibited a very similar pattern, increasing to almost 106% at year-end 2004 from less than 69% at year-end 2000, before declining marginally to 102% at year-end 2005. This ratio, one of the highest among MDFIs, implies that IIC would remain solvent even if all of its loans and equity investments were written off, as long as it suffered no losses on any of its other assets.

IIC's capital position is thus very strong. However, this is largely the result of the receipt of installments under the 1999 capital increase, supplemented by the slow growth of DRE, at least until 2005. Once the final installments under the 1999 capital increase have been received, in the absence of another capital increase, changes in IIC's risk-bearing capacity will be driven by its net income.

## Net Income

Like other MDFIs, IIC was never intended to be a profit-maximizing institution. Indeed, in light of the difficulty of its mandate, there was sentiment on the part of some shareholders at the time of its establishment that the corporation should simply break even, although that sentiment was not reflected in IIC's agreement.

As is true of other MDFIs, the drivers of IIC's net income are interest rate levels (because equity funds most of IIC's interest-bearing assets), the spread between interest earned on its interest-bearing assets and its cost of borrowing, the income on its equity investments, its provisions for losses on its loan and equity portfolios, and noninterest expenses (principally administrative).

As shown in table 8, IIC's net income historically has been volatile, and the corporation suffered large losses in 1999, 2001, and 2002 due to large provisions for losses on its loans and equity investments. Current management appears to be more willing to provision problem loans and equity investments in a timely manner, which should reduce loan losses as a source of volatility in net income.

Table 8

***IIC Net Income***

| | —Year ended Dec. 31— | | | | |
|---|---|---|---|---|---|
| ***(Mil. US$, unless otherwise indicated)*** | ***2005*** | ***2004*** | ***2003*** | ***2002*** | ***2001*** |
| Income from marketable securities | 5.3 | 1.1 | 1.3 | 1.7 | 2.9 |
| Interest income from loans | 22.3 | 17.1 | 11.9 | 12.1 | 20.2 |
| Income from commitment fees | 0.4 | 0.3 | 0.3 | 0.4 | 0.5 |
| Income from front-end fees | 1.0 | 0.8 | 0.7 | 1.0 | 0.5 |
| Other loan-related income | 0.4 | 0.4 | 0.5 | 0.6 | 0.3 |
| Income from loan investments | 24.1 | 18.6 | 13.4 | 14.1 | 21.4 |
| Provisions for loan losses | (3.5) | 6.0 | 4.9 | (30.1) | (11.3) |
| Total loan income | 20.6 | 24.6 | 18.3 | (16.0) | 10.0 |
| Interest from mortgage-backed securities | 0.0 | 0.0 | 0.3 | 0.6 | 0.2 |
| Gain (loss) on mortgage-backed securities | 0.0 | 0.0 | 1.3 | (1.8) | 0.5 |

Table 8

| ***IIC Net Income (cont.'d)*** | | | | | |
|---|---|---|---|---|---|
| | ***—Year ended Dec. 31—*** | | | | |
| ***(Mil. US$, unless otherwise indicated)*** | ***2005*** | ***2004*** | ***2003*** | ***2002*** | ***2001*** |
| Gain (loss) on derivative | 0.0 | 0.0 | (1.9) | 2.5 | (0.6) |
| Total mortgage-backed securities income | 0.0 | 0.0 | (0.3) | 1.3 | 0.1 |
| Gain on sale of equity investments | 0.4 | 1.6 | 0.9 | 0.5 | 2.1 |
| Dividends, other equity investment income | 1.9 | 2.7 | 1.7 | 1.6 | 1.3 |
| Income from equity investments | 2.2 | 4.2 | 2.6 | 2.2 | 3.4 |
| Provisions for equity losses | 3.6 | (9.3) | (4.4) | (14.4) | (14.2) |
| Total equity investment income | 5.8 | (5.0) | (1.8) | (12.2) | (10.7) |
| Advisory service, cofinancing, and other income | 4.3 | 2.5 | 3.0 | 2.1 | 3.1 |
| Borrowing expense | (5.2) | (2.9) | (2.9) | (2.0) | (6.6) |
| Other expenses | (0.1) | 0.0 | 0.0 | 0.0 | 0.0 |
| Administrative expenses | (18.7) | (16.7) | (15.5) | (16.0) | (14.1) |
| Net income | 12.1 | 3.5 | 2.2 | (41.1) | (15.3) |
| ***Memo items:*** | | | | | |
| Return on average assets (%) | 2.1 | 0.8 | 0.5 | (10.7) | (4.0) |
| Return on average shareholders' equity (%) | 2.8 | 1.0 | 0.7 | (14.9) | (6.1) |

In 2003 and 2004, loan write-offs were the lowest in recent years and recoveries were the highest, which supports the view that IIC's accounting for problem assets has become more conservative, as was warranted. Loan write-offs picked up modestly during 2005, to US$4 million, matched by provisions for losses of US$4 million and partially offset by US$3 million in recoveries of loans previously written off. Write-offs of equity investments were US$18 million, and US$4 million in provisions for losses was taken.

IIC's net income will no doubt benefit from increased interest rates during 2006 because most of its loans will continue to be financed by its shareholders' equity. The loosening of the restrictions under which IIC operates, as well as improvements in its lending and related practices, should also lead to a better financial performance. Nonetheless, as long as—and to the extent that—the focus of IIC remains on SMEs, profitability is expected to remain relatively low, even compared with that of most other MDFIs. In addition, given the small size of IIC's capital base, even after the 1999 capital increase is completed, the prospects for IIC to grow to a size where it can have a discernible impact on the growth and development of its LACMCs are not good.

## Borrowing And Liquidity

IIC's extremely strong capital position implies that it has little need to borrow to finance its assets. At year-end 2005, IIC's cash and marketable securities of US$207 million actually exceeded its outstanding borrowings of US$196 million. Unless IIC substantially increases its DRE, the ongoing capital increases imply that IIC will continue to maintain a very strong liquidity position at least through year-end 2007.

IIC's policies require liquidity to cover the greater of either 100% of undisbursed commitments or 65% of projected three-year net cash flows, and cash and marketable securities must cover at least 30% of those requirements. At year-end 2005, IIC's undisbursed commitments were less than US$66 million.

For the purpose of calculating its liquidity, IIC includes the undrawn balances under committed credit facilities from financial institutions rated 'AA' or higher. At year-end 2005, IIC had facilities from two different commercial banks, neither of which met this criterion:

- US$30 million from Shinkin Central Bank (A+/Stable/A-1+) under a facility expiring in December 2009, all of which was drawn.
- US$200 million under four facilities from Caja de Ahorros y Monte de Piedad de Madrid (A+/Positive/A-1). Two were undrawn at year-end 2005: one for US$50 million, expiring in October 2007, and one US$50 million, expiring December 2009. In addition, two facilities were fully drawn: one for US$50 million, expiring January 2011, and one for US$50 million, expiring March 2015.

Larger and more important than these, however, is a US$300 million facility from IADB, which expires in November 2010 and was completely undrawn at year-end 2005. Although Standard & Poor's does not include in calculations of the liquidity of MDFIs facilities from commercial banks, it does include IIC's facility from IADB. Accordingly, IIC's liquidity position is among the strongest of rated MDFIs.

## Comparative Data

Comparative data for IIC and 14 other multilateral lending institutions rated by Standard & Poor's may be found on pages 51 through 57 of Standard & Poor's Supranationals Special Edition 2005, which is available on RatingsDirect and at www.standardandpoors.com. Enter "Supranationals Special Edition 2005" in the search box and click on the title under "Credit Ratings" in the center of the screen. The 2005 edition will be updated by end-September 2006.

Published by Standard & Poor's, a Division of The McGraw-Hill Companies, Inc. Executive offices: 1221 Avenue of the Americas, New York, NY 10020. Editorial offices: 55 Water Street, New York, NY 10041. Subscriber services: (1) 212-438-7280. Copyright 2006 by The McGraw-Hill Companies, Inc. Reproduction in whole or in part prohibited except by permission. All rights reserved. Information has been obtained by Standard & Poor's from sources believed to be reliable. However, because of the possibility of human or mechanical error by our sources, Standard & Poor's or others, Standard & Poor's does not guarantee the accuracy, adequacy, or completeness of any information and is not responsible for any errors or omissions or the result obtained from the use of such information. Ratings are statements of opinion, not statements of fact or recommendations to buy, hold, or sell any securities.

Standard & Poor's uses billing and contact data collected from subscribers for billing and order fulfillment purposes, and occasionally to inform subscribers about products or services from Standard & Poor's, our parent, The McGraw-Hill Companies, and reputable third parties that may be of interest to them. All subscriber billing and contact data collected is stored in a secure database in the U.S. and access is limited to authorized persons. If you would prefer not to have your information used as outlined in this notice, if you wish to review your information for accuracy, or for more information on our privacy practices, please call us at (1) 212-438-7280 or write us at: privacy@standardandpoors.com. For more information about The McGraw-Hill Companies Privacy Policy please visit www.mcgraw-hill.com/privacy.html.

Analytic services provided by Standard & Poor's Ratings Services ("Ratings Services") are the result of separate activities designed to preserve the independence and objectivity of ratings opinions. Credit ratings issued by Ratings Services are solely statements of opinion and not statements of fact or recommendations to purchase, hold, or sell any securities or make any other investment decisions. Accordingly, any user of credit ratings issued by Ratings Services should not rely on any such ratings or other opinion issued by Ratings Services in making any investment decision. Ratings are based on information received by Ratings Services. Other divisions of Standard & Poor's may have information that is not available to Ratings Services. Standard & Poor's has established policies and procedures to maintain the confidentiality of non-public information received during the ratings process.

Ratings Services receives compensation for its ratings. Such compensation is normally paid either by the issuers of such securities or by the underwriters participating in the distribution thereof. The fees generally vary from US$2,000 to over US$1,500,000. While Standard & Poor's reserves the right to disseminate the rating, it receives no payment for doing so, except for subscriptions to its publications.

Permissions: To reprint, translate, or quote Standard & Poor's publications, contact: Client Services, 55 Water Street, New York, NY 10041; (1) 212-438-7280; or by e-mail to: research_request@standardandpoors.com.

The McGraw·Hill Companies