FMO

Finance for *Development*

Creating access

Annual Report 2006

Contents

‘There can be no sustainable growth in developing countries without a private sector…’ FMO Vision 2010

Based on our vision statement, FMO's mission is to stimulate sustainable economic growth and optimize development impact in emerging markets. Working in close cooperation with our global partner network, we create access to long-term capital and knowledge. We reach out to private enterprises directly or indirectly through local financial institutions and invest in infrastructure in order to build enabling environments for entrepreneurship.

FMO

Finance for *Development*

FMO key figures[1)]

	2001	2002	2003[2)]	2004[3)]	2005[4)]	2006
	Dutch GAAP			IFRS		
Development Impact Indicator (DII)					**390**	**570**
Balance sheet						**€ x 1 mln**
Net loans	981	829	848	902	1,010	1,130
Equity investments portfolio[5)]	84	76	82	93	128	216
Shareholders' equity	633	675	733	784	950	1,083
Debt securities and debentures/notes	777	648	914	895	1,139	1,004
Total assets	1,528	1,458	1,748	1,845	2,329	2,306
FMO and government funds committed portfolio	2,064	1,904	1,877	1,991	2,409	2,735
of which are government funds[6)]	143	160	201	247	350	519
Profit and loss account						**€ x 1 mln**
INCOME						
Interest income	119	106	102	111	121	142
Interest expenses	-42	-30	-26	-31	-41	-50
Net interest income	77	76	76	80	80	92
Income from equity investments[5)]	2	3	7	16	11	81
Other income including services	13	16	22	30	43	29
Total income	**92**	**95**	**105**	**126**	**134**	**202**
EXPENSES						
Operating expenses	25	31	33	36	41	47
Operating profit before value adjustments	67	64	71	90	93	155
Value adjustments						
- to loans and guarantees	49	46	39	33	-13	-8
- to equity investments	20	9	3	2	5	2
Total expenses	94	86	75	71	33	41
Share in the results of subsidiaries					0	4
Profit before tax	-2	9	30	55	101	165
Net profit	4	5	21	37	73	134
FMO in-house environmental and social ratios						
Average number of full-time equivalents (FTE)	164	192	196	197	203	224
Compensated CO_2 emissions (tons)[7)]				2,112	2,261	2,640

1) 2001-2003 figures are non-consolidated and have not been adjusted. 2004-2006 figures are consolidated. Because of the limited differences between consolidated and non-consolidated figures, the figures in the table are considered to be comparable.
2) According to annual accounts 2003.
3) Adjusted for comparative figures.
4) FMO and government funds committed portfolio 2005 and 2006 includes the fair value on equity investments.
5) Including associates.
6) The government funds include MASSIF, LDC Infrastructure, NIMF and EIB.
7) Calculation methods for CO_2 emission changed for 2006. For comparison reasons, 2005 was recalculated. FMO fully compensates its CO_2 emissions.

The role of FMO

What does it mean to be a development bank in the early years of the 21st century? As one of the world's largest bilateral development banks active in the private sector in emerging markets, for FMO it is all about making choices – choices on how to stimulate economic growth, choices on how to optimize development impact. FMO's choices are based on the proven concept that sustainable economic growth is stimulated by the development of a healthy private sector. A healthy private sector creates lasting jobs. Access to work and finance helps people learn new skills, improve their living standards and participate in and benefit from local production of goods and services. As living standards improve, more people benefit from growing prosperity. This is economic development impact. And this is why FMO concentrates on meeting demand for longer-term financing, including equity, from financial institutions offering microfinance and catering to local entrepreneurs and small- and medium-sized enterprises (SMEs). We are also meeting demands from the infrastructure sector and from local second-tier companies. These are high-risk sectors that require staying power, especially in the least developed economies. This is our work terrain; we know it, we understand it, we are willing to take the risks involved, and we can innovate to help clients meet the challenges they face as their economies develop.

STRATEGIC CHOICES

FMO has chosen to be a niche player with a clear strategic focus on two roles: we search out what we call the additionality and catalyst roles. The choice is in part driven by market circumstances. Today, vast financial resources in the commercial sector are looking for strong returns on short-term investments. Increasingly, commercial players are entering developing markets where they see opportunities. As they come into these markets, FMO has systematically shifted its focus. When the commercial players enter, we step back. We do not compete with them. Instead, we proactively look for 'additionality'. This means FMO works in the highest-risk markets and sectors where most commercial investors are not yet willing to enter, or only with some help. That is where FMO plays its catalyst role, lowering thresholds for private investors and financiers. We can do this because of our ability, experience and appetite to take on the most challenging investments, especially equity, and to carry a significant share of the risk. Because of our reputation, commercial banks and private investors are more likely to participate if FMO is a partner.

PARTNERSHIPS

FMO wants to keep its highly professional organization lean and focused. Rather than setting up offices around the world, FMO relies heavily on a well-established partner network. These partnerships, like FMO's focus, are long-term. We work closely with development banks, such as our German partner DEG, and local financial institutions, commercial investors and clients. Through this network, FMO has access to local investment opportunities and knowledge. The investment climate in our target countries is challenging. It is in these markets where we can play our additionality and catalyst roles to the full, as there is often little access to long-term capital. Our product range is demand driven. Increasingly, and in addition to loans, guarantees and other regular products, we are responding to demand for equity investments and mezzanine funding. Equity is often scarce in high-risk markets, especially for clients with no proven track record. FMO can offer true additionality here; it is our job to accept risks that are beyond the scope of commercial banks. Access to various forms of mezzanine finance allows for tailor-made service and is therefore very attractive for our clients.

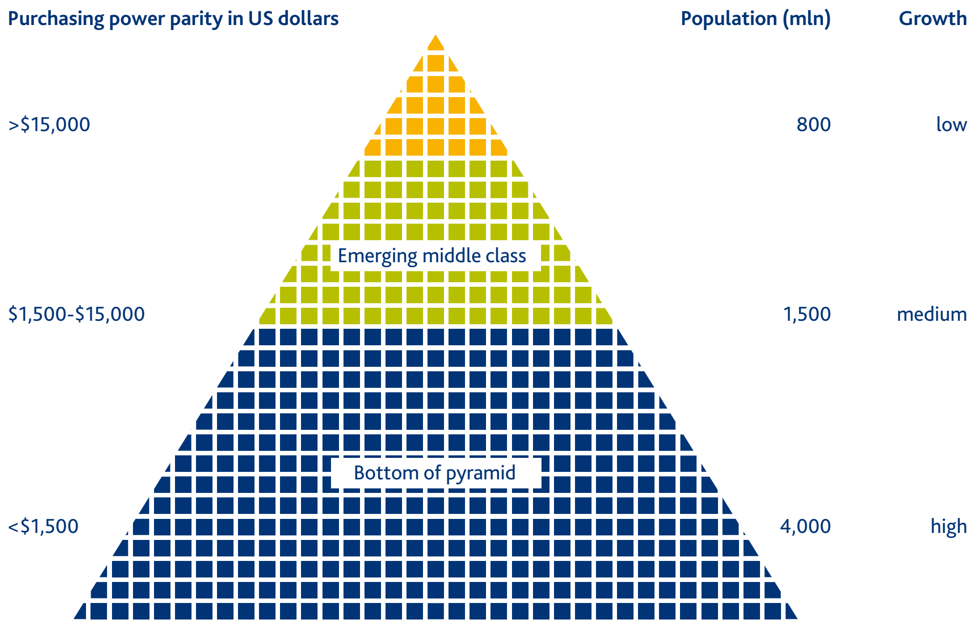
TARGETING DEVELOPMENT IMPACT

FMO's investment selection is focused on optimizing sustainable growth and development impact. It is a way of life and forms the foundation for the FMO mindset. We target investments based not just on financial viability, but on their potential to generate lasting development impact. The FMO 'scorecard' was created to measure this potential and it is used, among other things, to assess all investments. Using the scorecard, our 'deal teams', comprising investment officers, legal, environmental and social experts, assess the economic, environmental and social risks and impacts, corporate governance aspects and the special role and contribution FMO can play in the investment or finance project. At FMO, a good investment is only a good investment if it scores or has the potential to score sufficiently on these factors (for full details of scoring, please visit the website, www.fmo.nl).

MULTIPLE BOTTOM LINE

In the real world, development impact is not achieved overnight; developing means changing and it is a gradual process. Economic development impact is a pre-requisite for all projects. Besides economic impact, we safeguard high impact on social, environmental and governance components. For this reason, we calculate the expected development impact of new investments, based on the economic development impact score, or EDIS (see sidebar on page 5: Measuring development impact). Although EDIS may be a primary assessment factor in making initial investment decisions, when we work with clients, there has to be a willingness and a shared vision to recognize and accept the importance of social, environmental and governance factors as well. This is key in our way of doing business. FMO is committed to a 'multiple bottom line' concept. Our experience shows that good economic, social and environmental management and corporate governance impact tend to be interrelated; there can be no lasting development impact if social, environmental and governance components are excluded from the equation. During due diligence for category A and some category B projects (see sidebar on page 50: Environmental and social risk categorization), we make use of stakeholder involvement, such as local communities in big infrastructure projects, as part of the impact assessment process. Often, our choice to do business is based on that involvement, even if there are significant

THE WORLD ECONOMIC PYRAMID – BASED ON UN WORLD DEVELOPMENT REPORTS



development impact

Measuring development impact

At FMO, actual development impact is evaluated at the end of five years or on exit from an investment or project. Every investment is evaluated on the impact it has had on the local economy, society and the environment. Often, these impacts are positive. But not always, as some of the case studies in this report show. We learn from these evaluations. They have helped us develop the FMO 'scorecard'. And, from 2005, they have also enabled us to estimate expected development impact from new investments and projects. This is why the Development Impact Indicator (DII) was created and implemented.

One of our stated strategic goals to 2010 is to increase the DII by 50% compared to 2005. Performance on this strategic goal can only be measured if a benchmark is first established. This was done in 2005 by taking the Economic Development Impact Score (EDIS), multiplying it by the amount of new investments, and dividing the result by 100 to arrive at an annual score. In 2005, that score was 390. In 2006, it is 570.

It is unlikely that the exceptional performance of 2006 can be repeated every year. Each year we start with a score of zero. Moving into higher-risk countries and young local companies is likely to reduce our EDIS. In regional terms, we can already see this in Africa where 2006 showed the highest level of commitments coupled with the lowest DII.

challenges. We have found that good development outcomes typically go hand-in-hand with positive investment outcomes; a bankruptcy never scores positively. It seems that paying proper attention to sustainability issues is generally good for business. And if our clients are doing well, then FMO will also do well on its own continuity goals.

CLIENT VISION

In today's highly liquid market, commercial finance is often available to clients without the stringent sustainability criteria FMO builds into its contracts. Our clients make a clear choice. In that sense, we consider them to be visionary. They opt for a long-term commitment and partnership with FMO, recognizing and aiming for a multiple bottom line as well. Working with clients is about more than providing finance. At FMO, we see this partnership as building trust, sharing know-how, and managing and mitigating negative social, environmental and governance risks in a responsible way. We share our clients' vision of growing into healthy companies or financial institutions with a sustainable outlook. They create the economic vitality that contributes to increasing prosperity and improved quality of the societies in which they operate.

FMO has an AAA rating from Standard & Poor's. The Dutch State is the majority shareholder (51%); Dutch commercial banks own a further 42%. The remaining 7% is held by employers' associations, labor unions, private companies and individuals.

THE GLOBAL NETWORK OF FMO

GLOBAL PARTNERS

- Aureos
- Citibank
- DEG

DII: 135

€701 million (26%)

LATIN AMERICA & THE CARIBBEAN KEY PARTNERS

- Advent Latin American Private Equity Fund
- CAF
- Conduite Capital Partners
- DBA Corporate Finance

Many of FMO's markets are among the least developed and often highest risk in the world. These are our focus. To be most effective in these markets, FMO must build on its core strengths, on its niche roles. This includes bringing unique financial products to clients, such as local currency financing and capacity development. Another niche is our extensive sector expertise in financial markets, infrastructure (roads, telecommunications, energy and water), and in second-tier companies. We recognize that we cannot be everything to everyone. Most importantly, we see that we can be most effective by working with a global network of partners and by expanding our relationships with clients.

DII: 169

€705 million (26%)

EUROPE & CENTRAL ASIA KEY PARTNERS
- Advent
- EBRD
- EFSE
- Euroventures Ukraine Fund
- Horizon Emerging Europe Growth Fund

DII: 141

€610 million (22%)

ASIA KEY PARTNERS
- ADB
- Aga Khan Foundation for Economic Development
- DPF China
- ICICI (India)
- Standard Chartered Bank

DII: 125

€719 million (26%)

AFRICA KEY PARTNERS
- AfricInvest Fund Ltd
- EAIF/GuarantCo
- Kingdom Zephyr Africa Management UK Ltd.
- Standard Bank
- Tuninvest

MANAGEMENT BOARD

Arthur Arnold (1946), Chief Executive Officer

Arthur Arnold was appointed as CEO on January 1, 2005. Prior to joining FMO, he was President and CEO of the World Council of Credit Unions for five years. From 1992-2000, he served the Rabobank Group as Director of Investment Banking and Chairman of the Management Board of Rabobank International. Prior to Rabobank, he worked for ABN AMRO Bank for 24 years in management positions across the globe.

Nanno Kleiterp (1953), Chief Investment Officer

Nanno Kleiterp has been responsible for FMO's risk-bearing portfolio as Chief Investment Officer since 2000. From 1987-2000, he held a number of positions with FMO, including Manager Small- and Medium-sized Enterprises, Regional Manager Latin America and Chief Finance Officer. Prior to FMO, he gained extensive experience in private-sector development while working in Nicaragua, Mexico and Peru.

Nico Pijl (1951), Chief Risk & Finance Officer

Nico Pijl was appointed Chief Risk & Finance Officer in 2005. From 1986-2005, he held a variety of FMO positions, including Chief Portfolio Officer, Senior Investment Officer, Regional Manager Latin America & the Caribbean and later Asia. Prior to FMO, he worked for nearly 10 years at the United Nations and the World Bank.

Letter from the CEO

Dear stakeholders in FMO,

The reporting year, 2006, will be remembered as an extraordinary one in the history of FMO. Development returns, financial returns and operational returns together increased FMO's multiple bottom line to record levels in a rapidly changing environment.

Optimizing development impact resulted in a 46% increase of the Development Impact Indicator (DII) against 2005. As explained in this report, both components of the DII – the quantity of newly contracted investments and the quality of those investments – made a major contribution. Our strategic goal is to achieve a structural increase in FMO's DII in the coming years, reaching a 50% increase in 2010 over 2005 levels. Getting there will most certainly be a dynamic process.

Financial results exceeded all expectations. Since only a very small percentage of net results of €134 million are paid out to our shareholders, the balance qualifies as retained earnings. As a result, FMO's capital now exceeds €1 billion, providing us with a solid base from which to grow our development finance business in the future.

FMO's strong development and financial performance in the last few years is no guarantee of future success. Our business is highly cyclical. When the global economy is growing our clients and partners benefit, which in turn reflects on our own performance. However, should a crisis occur, FMO, with its strong capitalization, will be able to continue providing access to finance, in particular for those clients and local partners in the private sector who may then need us.

In operational terms, in 2006, we implemented two major new ICT systems; we introduced Compliance and Know Your Customer to our clients and partners, as well as internally; we started a Business Process Review to increase operational efficiency; and we invested in our human capital. Increasing and sharing our knowledge base, changing from an organization of professionals into a professional organization, are all part of better serving our clients and partners.

Two developments are having a major impact on our clients and partners. One is the excess liquidity in global markets. Consequently, in 2006 we saw commercial investors and banks taking FMO's place, which is great from a development point of view. In the absence of a crisis we expect this trend to continue.

The second change we see is the increasing importance of South-South investments (from the BRICs, i.e. Brazil, Russia, India, China, but also from Turkey, South Africa, the Middle East, etc., into the South) compared to North-South investments. We expect that in the years to come this trend will dramatically change our playing field and thus the relevance of the development finance institutions (DFIs) from the North, such as FMO. Both trends reinforce the need for FMO to make choices. That is the red line running through this report.

Since sustainability is an integral part of FMO's way of doing business, we have decided to integrate sustainability for the first time in this 2006 Annual Report, instead of reporting separately in a Sustainability Report as we have done in the past two years.

I am proud to be part of the 'One FMO' team. Together, we face the challenges of serving our clients and local partners. We show guts by using our core competences of structuring finance in high-risk markets. We demonstrate our power of understanding by listening to, and learning from, our clients and partners, and then assessing and adapting to local circumstances. Once we have committed ourselves, we are there for the long haul, making sure that change, i.e. development, takes place.

On behalf of the Management Board, I thank all stakeholders, including our clients and partners, our shareholders, our Supervisory Board of Directors, our Works Council, and last but not least, all our employees for their trust and dedication in 2006.

FMO is in a strong position to face the challenges of 2007 and thereafter.

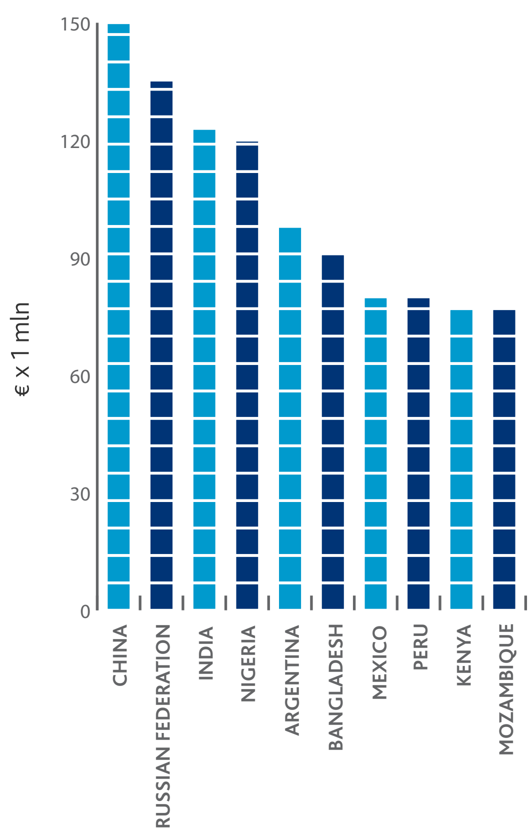
Thank you,

Arthur Arnold,
CEO

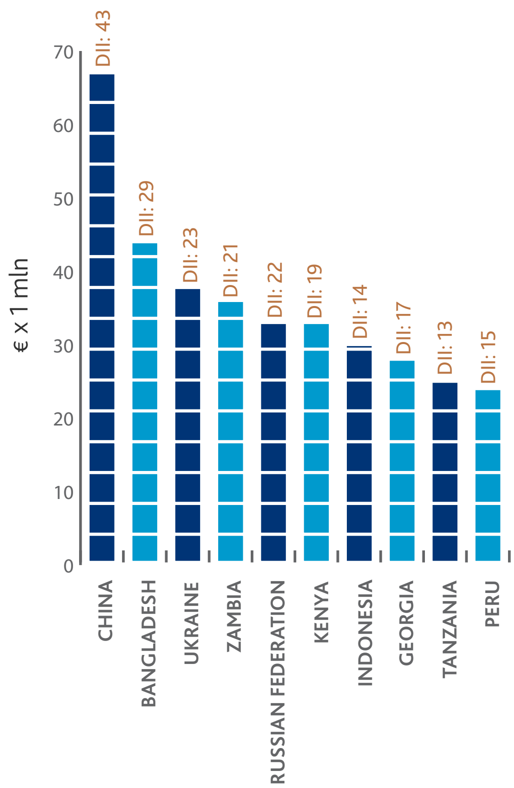
Report of the Management Board

FMO's longer-term strategy to 2010 is designed to achieve two interrelated goals. The first is to reinforce FMO's position as a niche player with a clear focus on a 'complementary' role in the market (additionality) and involving market players to maximum effect (our catalyst role). The second is to pursue our shift into the most challenging, highest risk emerging economies, although we are only able to meet a tiny proportion of the demand for the long-term (financial) commitment that is so scarce in those markets. The innovative 're-use' of our resources is, therefore, crucial in growing our deal flows to serve more clients more effectively. Both goals are derived from our mission to stimulate sustainable growth and optimize economic development impact. We pursue our strategy based on the 'multiple bottom line' concept. Our activities, both with clients and in the way we operate our business, are structured according to well-embedded, integrated economic, social, environmental and governance concepts. This report provides a detailed overview of overall performance in 2006.

TOP TEN COUNTRIES IN PORTFOLIO



TOP TEN NEW CONTRACTS WITH DII



Our strategic targets to 2010 (set in early 2006) are:

- increase economic development impact by 50% compared to 2005 benchmark (2006: 46%);
- growth of committed portfolio to €3.6 billion (2006: €2.7 billion);
- a minimum of 35% of investment in low-income countries (2006: 36%);
- balanced distribution over all four FMO regions (2006: Africa 26%, Asia 22%, Europe & Central Asia 26%, Latin America & the Caribbean 26%);
- share of equity and mezzanine investments 50% of the total portfolio (2006: 35%);
- government funds 25% of total portfolio (2006: 21%);
- local currency financing 20% of total portfolio (2006: 13%);
- through 'One FMO', continue to transform ourselves from an organization of professionals to a professional organization, complying with internationally accepted standards.

As 2006 results show, we have made considerable progress on our Strategy 2010 targets. All these targets combine to drive our mission forward.

Optimizing development impact is both our mission and primary target. All our working processes are geared to identifying opportunities to achieve economic, social, environmental and governance development impact. As part of our One FMO program, we further refined the multiple bottom line approach to investment and finance. Our financing consists of six basic steps:

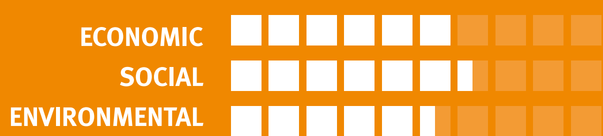
1. identifying opportunities;
2. appraisal;
3. approval;
4. contract;
5. monitoring;
6. impact evaluation.

Motorcycle finance mobilizes Indonesian community

PT Federal International Finance (FIF) is a consumer finance company specializing in motorcycle finance in Indonesia. FIF enables low-income customers to buy a motorcycle, often for the first time. The positive impact is multi-fold: a motorcycle acts as an efficient and effective means of transport, both for the customer and often for their family as well, which can be used for commuting to work and other purposes. Small businesses, such as taxis, couriers and mobile kiosks, can also be set up with the aid of a motorcycle, thus improving the local economy.

FMO, alongside partner ABN AMRO, has provided a US $100 million syndicated loan, which allows FIF to grow its business in a more sustainable way. The loan was successfully syndicated to nine financial institutions, some of which were investing in Indonesia for the first time since the Asian financial crisis of the late 1990s.

Ida Lunardi, President Director of FIF, comments: 'one of the most important missions of FIF is to support the sustainable growth of Indonesia. We are proud to have FMO as our partner in this mission through providing retail finance for motorcycle purchases; this has resulted in the extensive development of small-scale businesses such as food sellers and delivery operations.'



Partnership between development and commercial banks

In the first formal global partnership between a European development finance institution (DFI) and a leading commercial bank, FMO and Citigroup have launched a US $540 million risk-sharing facility. The initiative aims to provide loans to small- and medium-sized companies in lower-income countries. FMO has guaranteed a share of up to US $350 million in aggregate, and carries 65% of the risk.

The facility will generate employment, local wealth and tax income, as well as increasing borrowers' access to local currency financing. The combined skills and expertise of the two companies will enable positive influence over the clients' social and environmental performance and corporate governance standards. One of the first countries to benefit from this first-of-its-kind risk-sharing facility is the Dominican Republic in the Caribbean. The facility has provided US $25 million (US $14.4 million from FMO) to the Monte Rio Power Corporation, to improve the finance structure. The investment helps to improve the power plant's performance, which brings energy to homes, businesses and classrooms across the country.

Patrick Brockie, Managing Director of Citigroup's Export and Agency Finance Group, comments: 'this risk-sharing facility demonstrates how DFIs and commercial banks can work together to promote sustainable growth in developing countries.'

ECONOMIC
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In identifying opportunities, we are looking to achieve development impact rather than just financial viability. It is our job to take risks. We put together a deal team for each opportunity identified. Typically, a deal team will comprise one or more investment officers, a legal and a social and/or environmental expert. During the appraisal phase, the deal team assesses the client's potential positive or negative effect on social, environmental and governance conditions and the client's perceptions of these impacts, as well as their willingness and ability to address and manage them. These components are incorporated into the so-called FMO scorecard. This helps our deal teams to keep track of both the investment's risks and the potential for lasting effects on economic growth and ensuing development impact. Contracting includes clear terms and conditions – FMO is not a charity; we finance on commercial terms. On social, environmental and governance factors, we require compliance with our standards, or the willingness and ability to reach compliance within a realistic timeframe; in such cases we develop an action plan with the client. During the lifetime of the investment, we monitor progress on all components and action plans on an annual basis. The impact evaluation is carried out after five years or on exit – development impact is a gradual process; it does not happen overnight.

In 2006, the FMO Management Board committed to adopting the new IFC Environmental and Social Performance Standards, and the second phase of the Equator Principles (see sidebar opposite: International benchmarks). In 2007, FMO will integrate and implement the new IFC Performance Standards in its financing procedures.

BENCHMARKING IMPACT

To facilitate focus on multiple bottom line impact, in 2005 we embedded procedures to calculate expected development impact on new contracts. The base score on new contracts signed in 2005 was 390. By applying the same criteria to new contracts in 2006, we achieved a score of 570 or a 46% increase in expected development impact. The increase is a direct result of a greater focus on the EDIS coupled with a higher volume of contracts.

International benchmarks

EQUATOR PRINCIPLES

The Equator Principles have become the financial sector standard for environmentally and socially responsible project finance. Currently, more than 40 banks have committed to applying the IFC Environmental and Social Performance Standards to all project financing above US $10 million. FMO started to apply World Bank/IFC policies and guidelines to all its financing in 2000, including investments below the Equator Principles' threshold amount. FMO adopted the Equator Principles in 2005, and integrated the second generation Equator Principles in 2006. Although this has not affected FMO's financing criteria, it does express our endorsement of the principle of mainstreaming sustainability considerations in financial best practice throughout the sector.

If you would like to know more, please visit www.equator-principles.com for full details.

MILLENNIUM DEVELOPMENT GOALS

Agreed by all members of the United Nations in 2000, the Millennium Development Goals (MDG) are of major significance as this was the first time ever that an international commitment was made to tackling poverty in a concerted way. The same broad consensus is also a weakness; the MDG are quite general in concept. No mention is made of private-sector development and access to finance. We believe this is a missed opportunity. At the same time, FMO fully supports a commitment, however general, aimed at:

- MDG1: eradicating extreme poverty;
- MDG7: ensuring environmental sustainability;
- MDG8: developing a global partnership for development.

All are goals shared by FMO. For more on the MDG, visit www.un.org/millenniumgoals.

Power of understanding –

‘listening and learning from our clients and partners…’

The portfolio

A number of strategic targets drive the composition of our portfolio. We apply an integrated management approach so that we avoid concentrations on regions, countries, sectors and types of products. This supports our desired geographic portfolio spread over all four FMO regions. In terms of sectors, we focus on finance, infrastructure and second-tier companies in higher-risk emerging markets. Our partner network is vital in expanding our reach to even more clients. In partnership with development finance institutions, such as DEG, international commercial banks and regional or local investment funds, we spread our resources and share risk.

A SWOT analysis of our portfolio shows that every strength is also a weakness, an opportunity and a threat, and vice versa.

STRENGTHS

OPPORTUNITIES

High liquidity in the market
South-South investment
National/regional crises
Increase in risk appetite of commercial banks
Increase in early repayments
Higher-risk countries in portfolio
Second-tier companies in portfolio
Higher-risk products (e.g. equity and mezzanine)
FMO's additionality and catalyst roles

THREATS

WEAKNESSES

SECTOR FOCUS – FINANCE

Investing in the finance sector is seen as key to our sustainable economic growth and development impact goals. More than four billion people in developing countries lack access to basic financial services such as credit, savings and insurance. A properly functioning and inclusive financial sector has a proven link to economic growth and poverty reduction. This is why FMO concentrates on facilitating development in this sector. The financial sector impacts economic growth in a number of ways. Improving access to financial services for all consumers and a broad spectrum of enterprises, from large exporters to SMEs and micro-entrepreneurs, helps mobilize local resources. Ultimately, local savings and deposits should be the sustainable source of private-sector funding. A healthy financial sector is also important for a more efficient allocation of resources (over time and over sectors); it further facilitates the entry of foreign investment. It can help spread economic risk so that production and trade volume increases. For FMO, all these components are targeted in our financial sector focus. We aim to help stimulate economic growth; target clients include the enterprises that can drive a healthy economy. At the bottom of the pyramid, we work with partners and clients to support the development of local banks and, increasingly, professional microfinance institutions opening up financial services to more of their own customers. In this role, we use our MASSIF financial sector fund, which traditionally focuses on partners financing or taking equity in SMEs.

INFRASTRUCTURE AND SECOND-TIER COMPANIES

Infrastructure is key in creating a 'backbone' for economic activity. We invest in or finance clients working on roads, harbors, telecommunications, energy and water. The Least Developed Countries (LDC) Infrastructure Fund also allows FMO to take risks in this

Serbian bank provides opportunities for entrepreneurs

Opportunity Bank Serbia (OBS) is the only savings bank operating in Serbia. It provides assistance to SMEs, start-up and growing entrepreneurs, and their families. The aim is to improve the quality of life of customers by giving them access to financial services from which they are normally excluded by commercial banks.

FMO's equity injection of €2 million will be used to support OBS's plans to become a commercial bank. It is expected that the National Bank of Serbia will grant them a full operational license in the first quarter of 2007. John Schubin, CFO of OBS, says, 'becoming a commercial bank will provide a platform for improved customer service offerings and funding, but our mission remains the same: to improve lives by financing people excluded from mainstream banking.'

The initial equity funding has been provided out of MASSIF. Subsequent to licensing, FMO intends to provide a €4 million debt facility in either euros or local currency.

The positive development impact is high, in terms of customers, small enterprises, employees and Serbian society at large. Moreover, environmental and social coordinators have been appointed to ensure that OBS's environmental policy is upheld and labor standards, salaries and training are above national average.

ECONOMIC
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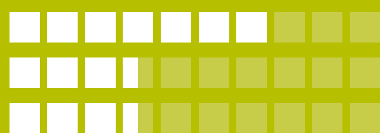

Sustainable power in southern Tanzania

In 2004, FMO provided US $1.7 million to Artumas Group Inc. in the form of a development grant with warrants. The grant helped realize a fully integrated energy project in the Mtwara region of southern Tanzania. In 2006, the energy project started to pay off. Once completed, the venture will bring power to 250,000 people, improve the infrastructure for the entire area, create jobs in construction and other services, and provide an ecologically sustainable power source.

FMO has provided three different types of finance over time. The initial grant plus warrant is an innovative financing product that means that if the project fails, the money is treated as a grant; if successful, however, FMO benefits from a return on its investment. Subsequently, FMO has provided US $14.5 million in equity from the LDC Infrastructure Fund in 2006, and a €22.5 million Development Related Export Transactions (ORET) grant that has been approved for 2007. Another four financing initiatives are in the pipeline.

Stephen Mason, President of the Artumas Group, says, 'we are pleased to have FMO as our joint venture partner. Their contribution has greatly assisted the economic viability of the Mtwara energy project and meets the challenges of rural electricity supply. The region's power supply now promotes one of the most economically, socially and ecologically sustainable regions in East Africa.' FMO has also appointed a member of Artumas' board, ensuring the transparency and good corporate governance of the company.

ECONOMIC
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sector that would otherwise be beyond our appetite. In some cases, our partner role takes on new innovative features, such as a unique grant warrant structure. If the investment fails, then the loss is covered. If it succeeds, equity can be taken from the warrants. To date, outcomes have been positive both for clients and for FMO.

Second-tier companies are an opportunity to fulfill our additionality role as these promising, mostly young and dynamic, clients often lack a track record and, thus, access to long-term capital. By providing finance or taking equity, we support their potential to grow into healthy companies that contribute to economic growth. Second-tier companies in sectors with significant environmental and social risks often require specific attention to the development of adequate mitigation strategies to manage these risks. FMO does this through extensive due diligence and, if needed, by drawing up an action plan with the client in order to realize all necessary improvements in a realistic timeframe. Progress is monitored on an annual basis. Government funds NIMF and FOM enable us to take an extra step in terms of the level of risk we are able to take.

In 2006, we signed 174 new contracts. FMO is now managing 666 investments for 453 clients with a total value of €2,735 million (2005: €2,409 million). The tables show the spread of our committed portfolio according to income categories.

COMMITTED PORTFOLIO PER COUNTRY INCOME GROUP IN 2006

	Lower income		Lower-middle income		Upper-middle income		Total all income groups	
	€ x 1 mln	%	€ x 1 mln	%	€ x 1 mln	%	€ x 1 mln	%
FMO A	652	24	959	35	545	20	2,156	79
FOM	3	0	25	1	31	1	59	2
MASSIF	130	5	127	5	12	0	269	10
LDC Infrastructure	184	7	0	0	19	1	203	8
NIMF	9	0	31	1	0	0	40	1
EIB	7	0	0	0	1	0	8	0
Total	**985**	**36**	**1,142**	**42**	**608**	**22**	**2,735**	**100**

COMMITTED PORTFOLIO PER COUNTRY INCOME GROUP IN 2005

	Lower income		Lower-middle income		Upper-middle income		Total all income groups	
	€ x 1 mln	%	€ x 1 mln	%	€ x 1 mln	%	€ x 1 mln	%
FMO A	659	27	953	40	404	17	2,016	84
FOM	9	0	20	1	13	1	42	2
MASSIF	126	5	74	3	12	1	212	9
LDC Infrastructure	91	4	0	0	0	0	91	4
NIMF	8	0	28	1	0	0	36	1
EIB	8	0	1	0	3	0	12	0
Total	**901**	**36**	**1,076**	**45**	**432**	**19**	**2,409**	**100**

Access 2010

The ‘Access 2010’ initiative was launched in mid-2004; its goal is to leave a positive ‘footprint’ in the financial sector of four small regions: Mekong Delta, the Balkans, Western Africa and Central America. These regions are in the early stages of financial development, and as such represent the highest potential for development impact.

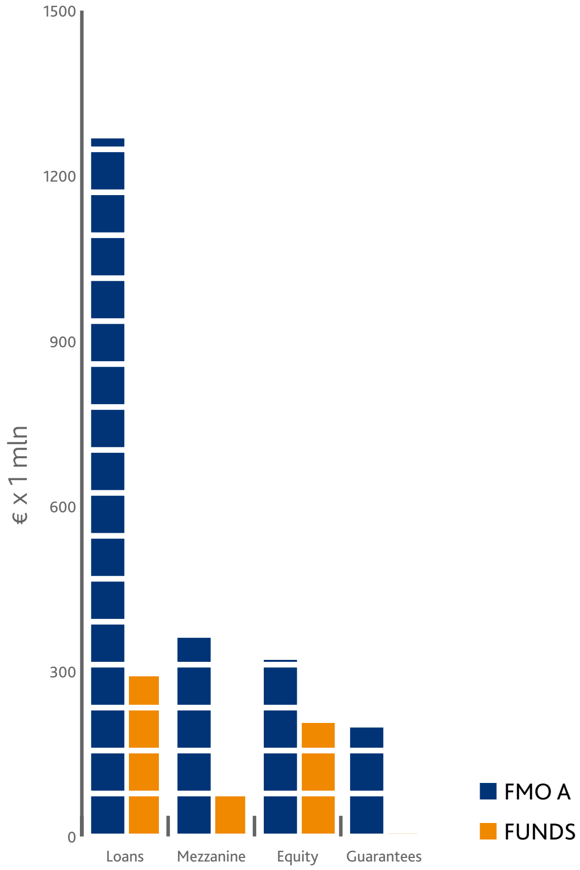
In 2006, through the Access 2010 initiative, we provided loans and equity investments to four new microfinance institutions in the Mekong Delta region. We also signed the first long-term local currency loan in Vietnam for mortgage financing. In West Africa, we targeted infrastructure projects in our new contracts. In the Balkans, we entered Moldova and increased our activities in Serbia, with capacity development as an integral part of many of our investments in the region. We have also continued our activities with banks in Panama and El Salvador. In 2007, we aim to continue our Access 2010 focus.

Our products

FMO's product range is growing steadily in response to client demand. We have long offered a variety of 'regular' products, ranging from straightforward loans and equity participations to structured finance and local currency and/or guarantees. With the Dutch government, FMO has set up various special-purpose funds and facilities, as well as a grant program for capacity development. These government funds and programs enable us to accept even greater risk and take positions in market segments whose high-risk profile would exclude commercial and/or private investment. We actively seek out these high-risk projects.

PRODUCT OVERVIEW

	Sectors		
	Finance	**Infrastructure**	**Trade & Industry**
FMO A	Loans • Guarantees • Equity and Mezzanine • Syndicated Loans		
Funds & Facilities	MASSIF	LDC Infrastructure Fund Access to Energy Fund	NIMF & FOM
Programs	Capacity Development		



COMMITTED PORTFOLIO IN EACH PRODUCT: FMO A AND FUNDS

EQUITY AND MEZZANINE FINANCE

Increasingly, our clients in the more challenging markets need tailored products. During our appraisal process, we work out the best solution for the client. Often, a combination of products will be structured. In recent years, demand for equity has grown considerably. Consequently, we have moved into higher-risk countries and sectors where equity is scarce. It also offers potential for good returns, which in turn supports our own financial continuity. Our goal is to 're-use' finance as often as possible to drive our deal flows. We make equity investments on the basis of an investment plan, market analysis, due diligence and the long-term commitment of management, shareholders, entrepreneurs and co-financiers. Expected development impact, calculated using our scorecard, drives participation; financial return objectives are determined based on market conditions. Where appropriate, we will also structure mezzanine transactions, combining equity and debt components. Mezzanine is an attractive tool for developing countries.

Worldwide emerging market enterprises boosted by private equity

Aureos Capital Limited is a leading private equity fund manager for under-banked SMEs in emerging markets, with more than US $500 million under management. FMO has invested US $2 million in preference shares and has two seats on Aureos' Board of Directors. Moreover, during 2006, FMO committed to investing a total of US $30 million in three funds managed by Aureos in South-East Asia, China and the Indian subcontinent. It has also been agreed that FMO will commit a further US $50–70 million to Aureos-managed funds in Africa, Latin America and Central Asia in the next few years.

Sivendran Vettivetpillai, CEO of Aureos, commented: 'FMO's investment and commitment to Aureos funds signals its confidence in Aureos' ability to deploy risk capital successfully in emerging market SMEs.'

Aureos' investments have a strong economic impact on the SME market, as risk capital is very scarce for this sector. The invested capital is expected to generate strong growth of the portfolio companies, with multiple knock-on effects in terms of positive impact on customers, suppliers, competitors and tax generation.

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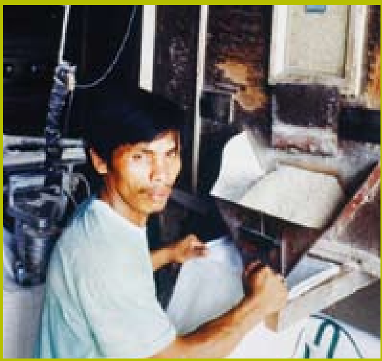

Microfinance boosts ‘bottom of the pyramid’ in Bangladesh

BRAC aims to alleviate poverty and create opportunities for the 70% of Bangladeshis who mainly work in farming activities. One of the largest non-governmental organizations in the world, BRAC operates in 140,000 Village Organizations in 64 districts in the country, with around 100,000 employees and five million borrowers. While BRAC's education and healthcare initiatives are dependent on subsidies, their microfinance activities are funded by local loans and client deposits.

FMO, in collaboration with KfW and Citicorp, has invested the equivalent of US $180 million in a microfinance securitization put in place by BRAC and RSA, a group of Bangladeshi professionals. This first-of-its-kind initiative has been denominated in the local currency, Bangladeshi Takas (BDT), meaning that there is no currency risk involved for BRAC or its clients. As extra security for the investors, BRAC provides 50% extra receivables and a monthly replacement of non-performing loans. As the historic repayment rate is already very good, this buffer gives extra comfort to investors.

The positive social development impact of the project is high: microfinance initiatives boost the ‘bottom of the pyramid’. BRAC's specific added value includes the transfer of technical skills, training on environmental protection and working conditions, and instruction on economic and legal issues. This transaction was awarded ‘Best Securitization Deal of the Year 2006’ by *International Financing Review*.

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It is not as high risk as straight equity, and our second-tier clients, often family businesses, see it as a softer option to equity. We work both directly and indirectly. Direct investment in private companies is with local partners and entrepreneurs or through co-investment with local and private equity funds. To meet our additionality and catalyst targets, we aim to ensure the participation and leading role of other experienced private investors by taking a minority interest, subscribing to between 10% and 25% of the investment's equity. Indirect investment is through participation in local and international private equity funds with proven track record. Our partner network plays a vital role in defining equity opportunities for FMO. Throughout the life of the investment, we actively contribute our expertise and provide input on guiding and monitoring growth. Generally, the investment horizon is five years, after which we evaluate the actual development impact. A well-defined exit strategy is part of the negotiations and structure.

In line with strategic targets, we expanded the share of equity and mezzanine products in all our regions. These products now represent 35% (2005: 32%) of the total portfolio.

LOCAL CURRENCY

We are convinced that access to local currency can enhance

PRODUCT SPREAD IN 2006

- FMO A (79%)
- MASSIF (10%)
- LDC Infrastructure (7%)
- NIMF (2%)
- FOM (2%)

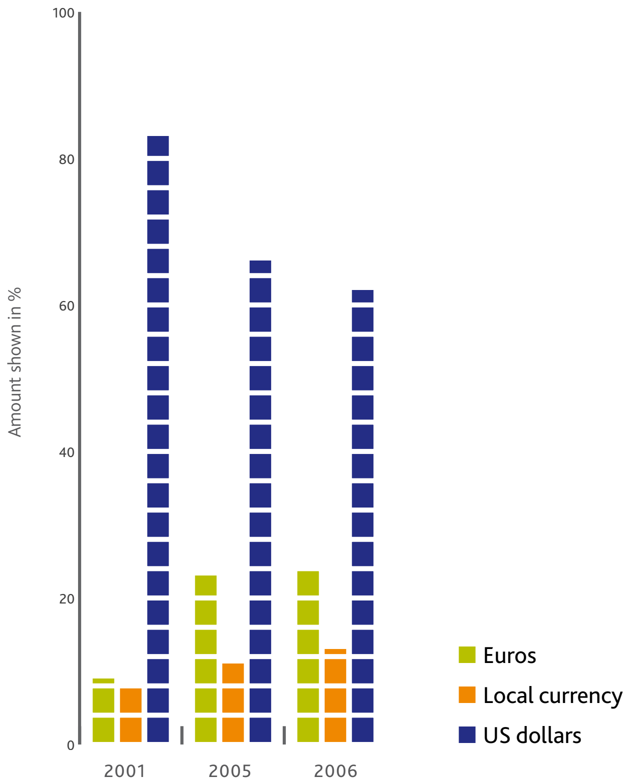
SECTOR SPREAD IN 2006

- Finance (56%)
- Infrastructure (20%)
- Trade & Industry (19%)
- Other (5%)

positive development impact in all regions. We take the view that access to local currency loans will reduce risk of bankruptcy. All successful enterprises contribute to the health of the local economy. A healthy local economy has social as well as economic impact. The majority of client revenues are in local currency. Often, foreign banks are not in a position to offer local currency on longer tenors or manage the currency risk involved in loans or financing denominated in foreign currencies. This is FMO's core business. Local currency products have always been available to clients through government funds. More recently, FMO began introducing its own products as a means of improving our service to clients. At FMO, we believe local currency products will become increasingly important in future. We envisage that 20% of our balance sheet will be made up of local currency positions by 2010. In preparation, we are working on sound geographic spreads through established country limits. In 2006, local currency financing represented 13% (2005: 11%) of the total portfolio.

NEW PRODUCTS

As more and more clients and prospects look to FMO for additionality and catalyst participation, we continue to work on innovations that will enable us to increase our activities. New, innovative products can support growing deal flows. During 2006, we have



PERCENTAGES OF PORTFOLIO IN EUROS, LOCAL CURRENCY AND US DOLLARS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been piloting a Credit Default Swap (CDS). This would enable FMO to sell risk to other parties so that we can channel the proceeds into other investments. Such advanced financial instruments are standard practice in sophisticated markets. We take the view that the rapid development of financial markets worldwide, due to positive economic growth, could make products like CDS viable opportunities for us and for partners looking to take advantage of our catalyst and additionality roles.

CAPACITY DEVELOPMENT

In 2006, we further streamlined this activity. Capacity development's goal is to provide knowledge transfer, which can help clients improve their businesses.

In practical terms, by integrating capacity development experts into regional teams, also as part of our One FMO program, we have been able to strengthen this offering. Capacity development can now be more easily incorporated into financial structures for clients. In the reporting year, we prepared a number of projects that will be carried out in 2007, including knowledge transfer in establishing an affordable housing project in South Africa; helping a microfinance institution in South America improve its organization, including corporate governance; and assisting in setting up a microfinance institution in Cameroon.

In addition to our capacity development facility, we offer a Financial Institutions Sustainability Support Program (the 'FI Program'). It helps our financial institution clients address environmental and social risks and opportunities in their portfolios. In 2006, we trained 20 financial institutions on sustainability issues, and supported 29 institutions by means of individual support missions. In 2007, a specific environmental and social training program for microfinance institutions will be piloted in Asia and Latin America.

GOVERNMENT FUNDS AND FACILITIES

With the Dutch government, FMO has set up and manages a number of funds and facilities for specific purposes. These are:

Worldwide finance network key to improving lives

FINCA International is a non-profit organization, which aims to provide financial services to the world's poorest families so that they can find employment, raise household incomes and improve standards of living. FINCA operates through a network of 21 microfinance institutions in 21 countries throughout Latin America, Africa, Europe and Asia.

FMO has provided €10 million through MASSIF as a multi-currency (involving only local currencies), multi-country facility. Financing is provided in local currency to avoid potential currency gaps and to hedge risk. FMO's role, however, is not merely financial; in the future, capacity development funds will also be provided for training purposes. FMO will actively assist FINCA in setting up environmental and social safeguarding processes, ensuring the long-term sustainability of the project.

According to Environmental and Social Specialist at FMO, Anton van Elteren, 'we ask FINCA International to operate an Environmental and Social Support System, which requires its client microfinance institutions to build Environmental and Social Management Systems to minimize risks with their clients – the final borrowers. This, coupled with local currency financing, is the best way to ensure sustainability into the future.'

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- MASSIF contributes to the development of financial services for small businesses and micro-entrepreneurs by increasing financial resources available to them and by strengthening the financial intermediaries that service these groups.
- Least Developed Countries (LDC) Infrastructure Fund provides long-term financing for (public-private) projects in energy, telecom, transportation, water, environmental and social infrastructure projects.
- Access to Energy Fund (AEF) contributes to improving access to affordable and sustainable energy services for the world's rural poor. Sub-Saharan Africa is a particular target area.
- Netherlands Investment Matching Fund (NIMF) offers long-term risk capital for international companies looking to invest in emerging markets.
- Investment Facility Emerging Markets (FOM) supports the development of emerging markets by encouraging investments by Dutch enterprises, especially SMEs.

Evaluating development

We assess potential development impact in the due diligence phase of a project using the scorecard; economic development impact receives a score (the EDIS) while social and environmental impacts receive equivalent scores. The EDIS is used to calculate the DII (see sidebar on page 5: Measuring development impact). We then evaluate the actual development impact after five years, or earlier if repayment is made before this time period. We call this evaluation 'ex-post' because it assesses whether the expected impacts have been achieved. We do not yet have ex-post scores for any of our projects because the DII was calculated for the first time in 2005. We will only find out whether those expected scores have been achieved in 2010 – five years after the first DII assessments.

NEW CONTRACTS PER REGION IN 2006

€ x 1 mln

Region	FMO A	MASSIF	LDC Infrastructure	FOM	NIMF	Total
Africa	150	17	55	-	1	223
Asia	166	36	18	4	5	229
Europe & Central Asia	214	28	-	19	5	266
Latin America & the Caribbean	178	21	20	-	-	219
Total	**708**	**102**	**93**	**23**	**11**	**937**

NEW CONTRACTS PER PRODUCT IN 2006

€ x 1 mln

Product	FMO A	MASSIF	LDC Infrastructure	FOM	NIMF	Total
Loan	496	67	62	20	-	645
Mezzanine	102	5	-	3	10	120
Equity	77	30	31	-	1	139
Guarantee	33	-	-	-	-	33
Total	**708**	**102**	**93**	**23**	**11**	**937**

t impact

Evaluation of development impact, however, is something we've been doing for several years, although the DII calculation itself is a more recent addition. Trends that we are seeing during the evaluation process are generally positive, as development impact over the past few years has steadily improved. This is thanks both to the positive economic climate and to improvements in FMO's working practices. Projects that have a high development impact also typically have high returns; of projects evaluated in the past three years, 72% produced positive development results, while 64% produced good financial returns for FMO. There is also a correlation between businesses that have high economic development impact and those that have good social and/or environmental practices. Clearly then, sustainability goes hand-in-hand with business. To the extent that sustainable investment helps business performance, paying adequate attention to sustainability is also good for FMO's multiple bottom line: clients that generate a poor financial return to FMO typically also perform poorly in sustainability terms.


partnership
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FMO by region

The term ‘region’ is a complex concept. For organizational efficiency and focusing our expertise, at FMO we talk about the regions: Africa, Asia, Europe & Central Asia, and Latin America & the Caribbean. However, each of these ‘regions’ is home to a diversity of countries whose level of development can range from least developed to developed. Asia and Latin America illustrate this point. Both generate ‘South-South’ investment. At the same time, they are home to some of the world’s poorest countries.

COMMITTED PORTFOLIO

- Latin America & Caribbean (26%)
- Europe & Central Asia (26%)
- Asia (22%)
- Africa (26%)

NEW CONTRACTS 2006

- Latin America & Caribbean (23%)
- Europe & Central Asia (29%)
- Asia (24%)
- Africa (24%)

What all our regions and their teams share is the challenge presented by high liquidity in the market. More and more commercial and private investors are entering our traditional markets. In response, we have moved up the risk ladder.

It is beyond the scope of this Annual Report to cover each of our many individual markets in any depth. What we can show here is: firstly, the way our 2010 strategy is driving our shift to the higher-risk, less developed markets and the second-tier companies and financial institutions that continue to find access to capital difficult. Secondly, how we are expanding and reinforcing our partner network, with a highlight in 2006 being the five-year €540 million risk-sharing agreement with Citibank, which is being deployed across our regions. And thirdly, how successful we have been in generating the levels of development impact that is our mission.

AFRICA

Although Africa has not generally been considered an attractive destination for international investors, there is increasing interest in the whole region. With some exceptions, the majority of African countries are politically more stable than in the past and are generating economic growth – overall GDP growth in 2006 was equally stable against 2005 at 5.1%. This means that commercial and private investors are more willing to accept the undoubtedly high risk. FMO welcomes all investment in development. In Africa, we had already shifted our focus from the first-tier investments that are attracting private and commercial capital. Since 2000, we have concentrated on specific infrastructure investments and financial institutions, including housing finance, especially in least developed countries.

In 2006, we had a number of strategic goals in Africa aimed at improving our DII score:

- continue our gradual shift away from the more traditional individual country focus to an approach based on forging long-term cooperation with preferred partners, who have strategic objectives in Africa and aim to make further investments;
- reinforce our support of larger infrastructure investments with significant development impact on the local economy, especially housing, water, energy, telecommunications and transport;
- innovative financing structures involving local currency.

This section describes our progress on these goals.

Africa is FMO's fastest growing region of activity. In 2006, 26% (2005: 26%) of the portfolio was in Africa. We signed 40 (2005: 36) new contracts with a DII of 125 (2005: 114). Effectively, our goal throughout Africa is to make the unbankable bankable in the least developed economies while supporting further development in more advanced countries. In 2006, African companies were doing well – this message was reinforced by the fact that, for the first time, a substantial part (€17 million) of the Africa portfolio was prepaid, specifically by clients in the telecoms or energy-related sectors. There is greater foreign investment into Africa, making it a challenge for us to continue growing our portfolio. Often, this is Chinese investment focused on the availability of raw materials, rather than on development impact or the establishment of governance, social and environmental best practices. In FMO's opinion, China's increased attention to Africa is positive, as it brings economic growth and development. However, efforts to engage in discussions with Chinese investors on environmental, social and governance aspects have not yet borne fruit.

These are conditions for sustainable economic growth and therefore 'must have' components in any FMO-financed investment. For this reason, FMO also targets strong, preferred partners with a fundamental interest in sustainability goals. In 2006, we entered new, or reinforced existing, partnerships with commercial financial institutions Standard Bank and RMB. Development partners

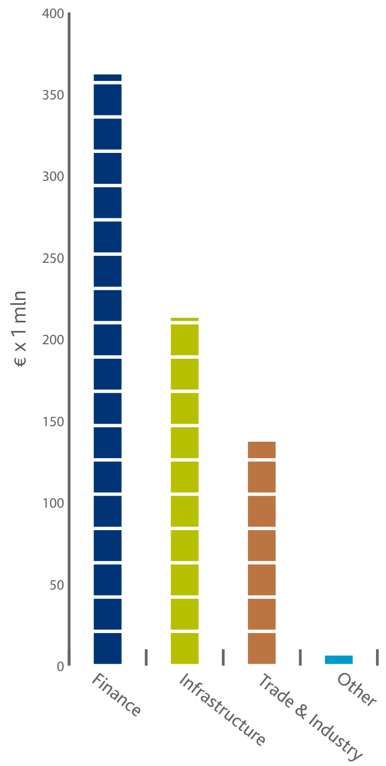
Focus 2007

- increase focus on our existing clients' and partners' needs;
- maintain and improve our Unique Selling Points – innovation, flexibility, knowledge and rapid response;
- maintain and improve our focus on infrastructure and the Access 2010 initiative;
- increase our focus on housing and partnerships with financial institutions focused on housing.

NEW CONTRACTS 2006

Product	€ x 1 mln	%	DII
Loans	121	54	69
Mezzanine	38	17	21
Equity	54	24	29
Guarantees	10	5	6
Total	**223**	**100**	**125**

COMMITTED PORTFOLIO PER SECTOR



include the Emerging Africa Infrastructure Fund and our European colleagues DEG and Proparco. Local financial institutions include Access Bank, BOA Group and Afriland. FMO considers local partnerships as crucial to achieving DII targets, especially on one-off investments. Our participation in an investment can often leverage our catalyst or additionality role. Deployment of, for example, the LDC Infrastructure Fund enables us to accept levels of risk that would effectively bar commercial and private investors from participating. Moreover, the LDC Infrastructure Fund enables us to take the highest possible development risk in the earliest stage. This will attract substantial additional investment flows into the developed projects. In the reporting year, we combined our Africa and LDC Infrastructure Fund teams to create a more powerful concentration of market and product knowledge.

Our Africa team sees the creation of a local currency facility as one of the key achievements in 2006; this unique initiative is a true One FMO effort with all disciplines contributing expertise. The local currency facility was launched through initial investments in Tanzania and Zambia, and is gradually being rolled out to other countries. Local currency finance is extremely important in generating development impact and sustainable growth. By offering local currency finance, with its reduced risk profile for users, development impact can be improved; it can result in more local employment and ensuing better standards of living.

Upgrade to Nigerian road infrastructure poses threats for micro-entrepreneurs

Currently, the roads in one of Nigeria's largest cities suffer from serious congestion, especially during peak hours. In the case of one major road in particular, a Nigerian investment company plans to upgrade 22 km of the existing highway and to widen 27 km of the road from four to six lanes, as well as to implement a toll system. Improvement of the road infrastructure would positively impact productivity, transport costs, environmental pollution and health and safety in the region, as well as allowing housing and other developments to proceed.

FMO is considering providing a US $20.3 million guarantee for a five-year tenor, as part of a total guarantee of US $52.6 million with two other partners.

Despite the predicted positive development impacts of the project, the building of the road has its downside. There is currently much 'informal' employment; the road is used by numerous street sellers. These people would have to relocate to alternative locations along the highway, with no improvement to the security of their livelihoods. Moreover, the businesses currently housed along the road would have to move their walls and fences, at certain inconvenience and expense. During construction, other risks include the availability of alternative roads as well as issues concerning occupational health and safety. Currently, discussions with the project investor are still in progress.

As this project is still in a preliminary phase, development impact scores have not yet been determined.

Hong Kong-based development fund grows local businesses

The Development Partners Fund (DPF) in Hong Kong provides mezzanine finance to medium-sized, fast-growing companies striving for further growth. The Fund was founded in 2005, when FMO invested US $22.5 million in funding. FMO's initiative and catalytic role has encouraged Hong Kong-based asset manager Value Partners Limited and Japanese corporate giant Itochu to co-fund DPF and join the fund manager, Development Partners Limited. New investors are continuing to contribute money to the Fund in 2006.

In situations like this, where indirect financing is involved, the environmental and social performance of the investee companies is particularly important. Investee companies must report regularly to the Fund, so that the environmental and social performance of the Fund's portfolio can be assessed. Development Partners Limited recently became the second organization in China to sign UNEP-FI: a collective agreement between the UN Environmental Organization and more than 160 financial institutions worldwide.

Corporate governance is also key to investments in China. Says Mark Kooijman, General Manager of DPF, 'FMO is not only on top of its own investments in the Fund but, more importantly, FMO actively contributes to corporate governance through indirect board representation in almost all of DPF's investee companies.'

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ASIA

This may be the world's economic powerhouse, with enviable GDP growth in some countries and resulting significant improvement in risk profile. But there is still a lot for FMO to do in Asia. Despite both China and India's impressive and rapid development, and their growing role as South-South investors, they continue to be focus economies for FMO, especially for governance and social and environmental issues. Besides the big name economies, as always, FMO is also focusing on less developed and smaller countries in the region, looking specifically at under-serviced sectors and new product offerings. These include subordinated loans, long-term currency financing, capital market development through credit enhancement, funding for microfinance institutions in countries and regions such as Vietnam, Cambodia and Central India, second-tier companies throughout Asia, and long-term funding for infrastructure investments in Bangladesh.

In 2006, strategic objectives to improve our DII in Asia were:

- further supporting second-tier companies throughout Asia and financial institutions focusing on SMEs;
- strengthening our Access 2010 activities in the Mekong Delta;
- focusing on China, India and the Mekong Delta countries, with a renewed focus on Indonesia;
- 50% of transaction volume through co-financing with partners;
- increasing focus on mezzanine and local currency financing.

Our activities in Asia have expanded rapidly during the reporting year. Around 22% (2005: 21%) of the portfolio is now committed

Focus 2007

- focus on India, China, Indonesia and the Mekong Delta, mainly through setting up mezzanine funds with partners;
- increase share of mezzanine funding;
- increase local currency funding (also through MASSIF);
- implement capacity development in the Mekong Delta, Development Partners Fund (DPF) in China and microfinance funds in India.

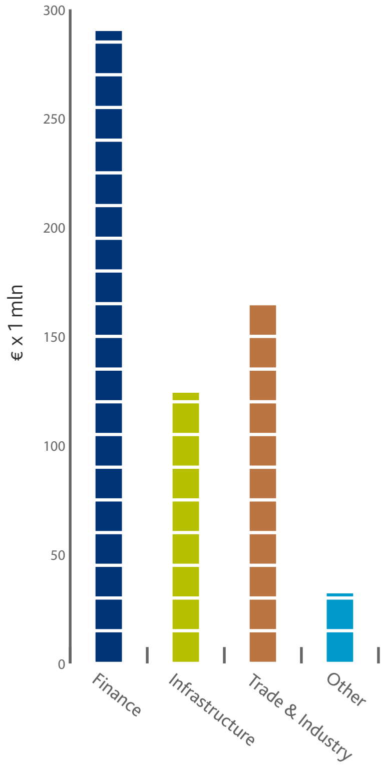
to Asia. We signed 42 (2005: 19) new contracts with a DII of 141 (2005: 77). Through careful targeting of activities we are able to generate a relatively high development impact. Equity investments totaled €123 million (2005: €66 million). Our primary goal is to support second-tier companies in promising sectors – the so-called champions of the future – that lack access to investment funding. As economic growth has begun to filter down in some countries, we are better able to mobilize local savings through capital market transactions, leveraging our AAA rating. In line with our Access 2010 commitment, we continue to focus these activities on the Mekong Delta. Both housing investments, in cooperation with a number of local Vietnamese banks, and finance for Cambodian microfinance institutions with bank status potential are target areas. We aim to enter Laos in the near future.

Local currency financing is becoming more and more important, especially for banks entering the housing market. We can serve this market through specific funds that allow us to extend long-term funding to SMEs, microfinance and infrastructure sectors. We intend to broaden our SME focus to Mongolia by teaming up with partners.

Indonesia is back on the FMO map as transparency/governance issues have improved tremendously. We have re-launched syndication activities and are working closely with Dutch banks ABN AMRO and Rabobank.

Our activities in China have grown significantly. The mezzanine fund launched in cooperation with Value Partners will reach €100 million in early 2007. Corporate governance, environmental management and the introduction of human resources skills and best practice are important focus points where we can add significant value. We are also moving inland, away from the well-established foreign direct investment destinations. The same applies in India; our intention is to launch a mezzanine fund in 2007, but the complex regulatory environment could delay its implementation.

COMMITTED PORTFOLIO PER SECTOR



Mezzanine funding is an increasingly important instrument, especially for companies looking to go public. We are also making it available to higher-risk companies – this is a growth activity for us in Asia. FMO is among a very select group of finance providers willing and able to offer mezzanine fund financing. Other more sophisticated products, such as subordinated loans, guarantees and, in some cases, credit enhancement for securitizations are increasingly part of FMO's offering to clients whose needs are changing as local economies continue to grow rapidly. Cooperation with partners is vital, especially with international commercial banks and in risk-sharing activities.

NEW CONTRACTS 2006

Product	€ x 1 mln	%	DII
Loans	176	77	106
Mezzanine	7	3	4
Equity	44	19	30
Guarantees	2	1	1
Total	**229**	**100**	**141**

EUROPE & CENTRAL ASIA

This region has made enormous progress during the past 15 years. The rapid development of new EU entrants and oil-producing countries has also had a knock-on effect for other countries. There is huge liquidity here; early repayment has become an issue. Competition is increasing from commercial banks which are now willing to take risks even FMO would have considered too high only a few years ago. This is especially true in Ukraine, where banks are changing hands for as much as five times book value. Banks are growing very rapidly, often doubling their balance sheet on an annual basis, and their need for capital and long-term funds is constant. Commercial investors now provide long-term funding, but equity and subordinated loans are still hard to attract. This represents a niche for FMO. Our primary focus in this region continues to be our strategic shift into higher-risk segments, second-tier companies and less obvious geographies. In countries such as Russia, we now work on regional development impact rather than in the major cities, using higher-risk instruments and structures. Our primary target countries continue to be the less developed in the region, also in line with our Access 2010 activities.

In 2006, we defined a number of strategic goals to achieve greater DII in the region:

- focus on Russia, Ukraine, Kazakhstan and Turkey;
- shift our focus to countries less attractive to European and regional investment. Effectively we will move south and east, to Access 2010 West Balkans and other countries where we can stimulate development impact through financial support and capacity development for financial institutions with an SME and microfinance client base;
- promote equity, mezzanine finance, guarantees and credit enhancement to stimulate further development of capital markets.

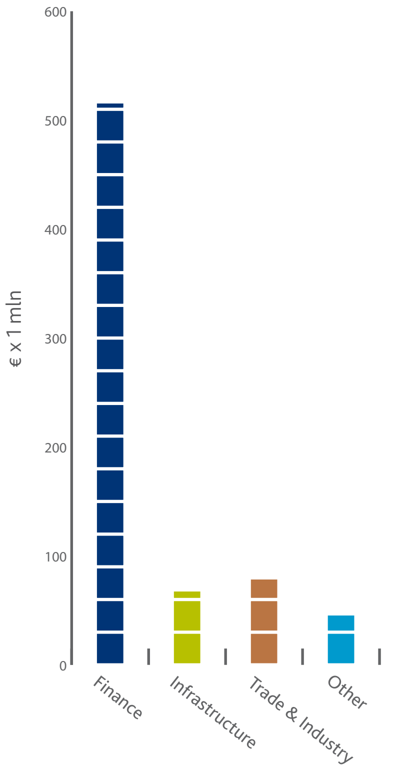
With 26% (2005: 24%) of the total portfolio committed to Europe & Central Asia, this continues to be one of our fastest growing regions. Some countries, such as Bulgaria and Romania, joined the European Union in 2007; we have stopped generating new business there. There is more than enough for FMO to concentrate on in other countries in the region. Despite higher-risk profiles of target countries, we managed to increase our DII score through greater volume and higher EDIS. In 2006, we committed to 58 (2005: 31) new investments with a DII of 169 (2005: 78); four investments are in new countries for FMO, Moldova and Azerbaijan.

Entry into Moldova is in line with our Access 2010 commitment; a €10 million regional multicurrency facility was arranged for a microfinance institution and we have financed a local currency loan for SMEs and microfinance institutions via MASSIF. Capacity development is an integral part of some of our investments. In 2006, we offered a financial package that includes this scheme to several financial institutions to improve the banks' corporate governance and social and environmental performance.

Focus 2007

- grow the share of corporates in the portfolio;
- increase our equity participations and mezzanine role;
- continue Access 2010 focus;
- work with our partners to meet KYC (Know Your Customer) requirements and policies.

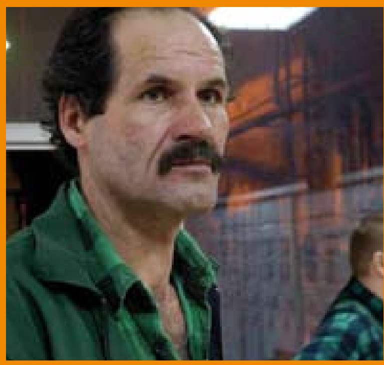
COMMITTED PORTFOLIO PER SECTOR



We increased our activities in Serbia and now have 10 investments there. One specific focus is equity and mezzanine for banks servicing the lower end of the market to stimulate access and financial services for SME clients. In our search for new investments that meet FMO's development goals, we have become more active in Georgia. For the region as a whole, our main challenge is redeploying early repayments, often as a result of M&A by commercial and/or private investors in Central Europe. This is exacerbated by steep falls in interest rates – sometimes by as much as 1%, due to huge liquidity. Clients are eager to re-negotiate existing commercial terms or simply prepay. Our competition often has less stringent legal, corporate governance and sustainability requirements. However, FMO's name continues to have added value as a demonstration of the client's sustainability and reliability.

NEW CONTRACTS 2006

Product	€ x 1 mln	%	DII
Loans	187	70	117
Mezzanine	45	17	28
Equity	24	9	17
Guarantees	11	4	7
Total	**267**	**100**	**169**



Divestment of pharmaceuticals company as Romania joins EU

In April 2006, FMO divested its 10% share in Terapia, the third largest pharmaceuticals company in Romania. The company was bought by a strategic commercial player, Ranbaxy – a large, quoted Indian company with a growing focus on Eastern Europe.

FMO's role as a development bank is to take risks that other, often commercial, investors are not willing to take. Terapia's old chemical plant – a legacy of the communist era that was privatized after the fall of the Berlin wall and used for the production of medicines – constituted a huge environmental hazard. Following FMO's investment, the plant has been demolished, the environmental problems resolved, new management put in place and new products conceived. Simultaneously, the Romanian market has considerably improved, not least because of its recent European Union status. These factors made the time right for FMO to divest. For FMO, it is important to divest only to parties that are committed to maintaining high sustainability standards. Now Terapia will receive further investments from Ranbaxy and will grow stronger, with positive knock-on effects on the local community.

ECONOMIC
SOCIAL
ENVIRONMENTAL

New mortgage system supports Mexican housing market

HipotecariaTotal (HITO), a new and innovative Mexican mortgage securitization service company, was created to alleviate Mexico's huge housing needs. Every year, there is a demand for an additional 700,000-900,000 housing units from Mexico's young population.

Uniquely, HITO is the first mortgage player outside Denmark to use the Danish mortgage system. Stable and robust, there has been no default on a Danish mortgage in over 200 years. The combination of fixed interest rates and an option to repay early helps shield borrowers from interest rate risk. If successful, this system will dramatically reduce the time between application and securitization, eliminate a number of steps in the process and diminish the costs of securitization.

Introducing this proven, cost- and risk-efficient concept in Mexico could lead to substantial social development impact. It provides increased access to capital for housing, stimulates the construction market and, by extension, employment, family savings and other knock-on effects on the local economy. It will also provide pension funds and insurers with a new class of mortgage-backed bonds.

FMO has made an equity investment of US $5 million, encouraging other local and international financial institutions to co-invest. Remco Polman, CEO of HITO, comments, 'FMO is perceived as reliable and knowledgeable in the Mexican housing market, and therefore sends a positive signal to the market.'

ECONOMIC

Category C financial institutions (see page 50) are not scored on their social and environmental impact. If successful, we predict a very high social impact for HITO.

LATIN AMERICA & THE

Overall as a region, Latin America & the Caribbean, known at FMO as LAC, is growing rapidly. The Central American Free Trade Association has contributed significantly to opening up intra-regional trade, promoting economic growth. This growth is driving rapid change. As elsewhere, liquidity is plentiful. Some LAC countries are also staking a claim in South-South investment, competing with international commercial and private investors. Strong M&A activity, especially in Central America's consolidating banking sector, has contributed to FMO's profitability as it exits equity investments. To date, the longer-term effects of a number of elections, specifically in Venezuela and Nicaragua, have still to emerge. In Bolivia, which was on the verge of national and social collapse, a change of government following elections has led to a call for the nationalization of assets; FMO has provisioned for this. As the region undergoes these rapid and diverse changes, FMO's challenge is to adapt. Its role has already changed due to the lower overall risk profile. The focus now is on second-tier companies and higher-risk products, such as mezzanine, equity and capital market structuring where it can leverage its additionality and catalyst roles.

In 2006, our strategic goals to stimulate DII were:

- adjust our regional strategy to maintain our additionality and move into higher-risk market segments (second-tier clients);
- diversify our pipeline within focus sectors;
- diversify to higher-risk (mezzanine) and new (local currency) products;
- increase visibility in the region;
- strengthen microfinance.

CARIBBEAN

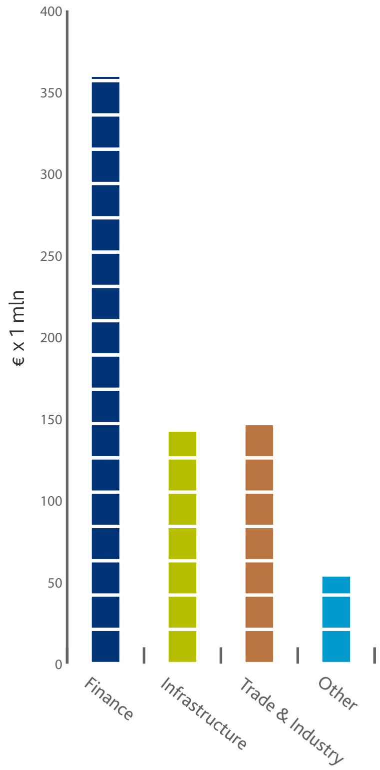
LAC is a dynamic and often financially volatile part of the world. Its diversity has always been a challenge. With economic growth strong in some countries, our task is to search out proactively those investments that can generate and drive true development impact. In 2006, we committed to 34 (2005: 25) new contracts with a DII of 135 (2005: 122) and a contract value of €219 million (2005: €221 million). The number of contracts and our profitability are somewhat deceptive. On the one hand, new contracts indicate that we are able to find investments that meet all our criteria, in spite of huge competition from both local and international investors looking for a home for enormous liquidity and in spite of limited interest in corporate governance. On the other hand, our high profitability levels in LAC this year, so important for our own continuity, are also an indication of some of the challenges we face. Early repayments amounted to close to €34 million. The recent shift in risk profile has led to the acquisition of several of FMO's LAC client companies by international commercial banks – a positive trend in itself. FMO has therefore been exiting these institutions in accordance with its catalyst strategy.

For the LAC team, an already complex region has become even more demanding and complicated. Performance on key criteria has been maintained and local conditions turned to advantage, specifically through high turnover in the portfolio enabling us to redeploy, and through the higher margins in higher-risk corporate and infrastructure sectors. Part of our challenge in LAC is to be creative in finding the right solutions and making more complex products available. One highlight for the LAC team was re-entry into the Dominican Republic, through the new global risk-sharing facility with Citibank. This was FMO's first deal with this new partner.

Focus 2007

- proactive portfolio management;
- continue to adapt to changing markets by entering new sectors with higher-risk products;
- strengthen our additionality role through increased focus on infrastructure, microfinance and second-tier companies;
- enter new markets.

COMMITTED PORTFOLIO PER SECTOR



NEW CONTRACTS 2006

Product	€ x 1 mln	%	DII
Loans	167	76	104
Mezzanine	24	11	17
Equity	17	8	10
Guarantees	11	5	4
Total	**219**	**100**	**135**

It is investments and the additionality that FMO can bring to the table that continue to work to our advantage in LAC. Our visibility is such that the FMO name is synonymous with a strong financial network and ability to offer structures other banks cannot. We were there in times of crisis; we are still there for those countries not in the process of economic boom, and for those that continue to need our development impact focus and ability to execute.


development
supporting emerging markets.

Risk management

Like all financial institutions, FMO's risk management is aimed at the careful and comprehensive management of the organization's business; it is geared to continuity into the future. However, by the very nature of its mission, FMO must be even more risk aware and better equipped to monitor, price and mitigate risk. This section of the Annual Report offers a summary of FMO-specific risks. For a fully detailed overview of risk management, please see the risk section in the financial statements or visit www.fmo.nl.

PHILOSOPHY

With its high-risk appetite to achieve development impact targets and its own profitability/sustainability goals, FMO applies an integrated portfolio risk management approach. This means we manage on the basis of risk, rather than on products or nominal amounts, while at the same time monitoring and evaluating investments on an individual basis. During due diligence on individual investments, the scorecard provides a useful tool. Through the integrated portfolio approach, individual investments are also reviewed from the risk concentration perspective. In this way, risk awareness, pricing, monitoring and mitigation are in place throughout the organization. FMO is able to make informed decisions on increasingly complex and higher-risk business where it can fulfill its additionality and catalyst roles, ultimately leading to greater development impact.

RISK MANAGEMENT FRAMEWORK

FMO has identified a number of key risks: strategic (including portfolio and profitability), operational, financial and reputation.

Monitoring, managing and mitigating these key risks forms the basis for our risk management framework.

STRATEGIC RISK

If FMO is to achieve its mission through strategic high-risk investment resulting in development impact, it must have the solid capital base and the strong financials essential to managing crises. Through its activities in high-risk countries and investments, FMO has a much higher risk profile than commercial banks and needs adequate human and operational/system capacity. Our 2010 strategy involves a clear shift towards an even higher risk profile. On average, FMO's level of risk weighting of assets is two to three times higher than that of commercial banks. Therefore, we maintain a higher capital adequacy ratio of between 20% and 25% rather than the regulatory minimum of 8% BIS ratio. Current capitalization levels are more than adequate to absorb risks in our portfolio.

OPERATIONAL RISK

Our operational risk is defined as risk resulting from inadequate procedures, also on compliance, information systems, errors or fraud by employees. All can lead to reputation risk (see page 41). In line with sound governance practice, FMO has in place a comprehensive internal control framework to limit operational risk (see In Control Statement on page 60). An annual audit plan has been agreed by the Management Board and the Supervisory Board's audit committee. FMO has a clear division of roles, responsibilities and accountabilities in its closing, settlement and positions procedures. Internal audit plays a key role through regular audits on critical operating processes, including the reliability of our financial reporting, our operational effectiveness and efficiency – all in line with compliance requirements. The director of this department reports regularly to the Management Board and Supervisory Board's audit committee. Policies on ICT systems are embedded in the internal control framework. In 2006, risk management components were further integrated into ICT systems. Our Audit, Compliance and Control department monitors compliance with the Dutch Corporate Governance Code, our own internal Code of Conduct, and other applicable compliance policies and procedures.

In recent years, FMO has shifted its investment focus up the risk ladder. Increasingly, and because commercial banks are more willing to make first-tier investments due to the strengthening of some emerging market economies, FMO is offering higher-risk products as well as focusing on higher-risk countries and so-called second-tier companies.

FINANCIAL RISK

Similarly to strategic risk, FMO's financial risks are managed and mitigated in order to achieve and maintain continuity into the future. In recent years, FMO has shifted its investment focus up the risk ladder. Increasingly, and because commercial banks are more willing to make first-tier investments due to the strengthening of some emerging market economies, FMO is offering higher-risk products such as equity and mezzanine financing that are in great demand by our clients (higher loss given default). We are focusing on higher-risk countries, especially in Africa, and so-called second-tier companies (higher probability of default). These shifts, and the knowledge gained from dealing with a succession of crises (Asia, Russia, Turkey and Argentina) in recent years, has also led to a shift in the way FMO manages its financial risk. One factor has not changed: FMO continues to seek out reliable partners only.

REPUTATION RISK

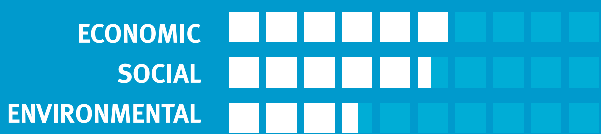
FMO aims to play a catalyst role. Our participation in a high-risk project often acts as the catalyst for other players. By carrying a significant, additional, part of the risk and through our expertise in these highest-risk areas, commercial and private investors gain the confidence to participate. However, these markets are not without typical reputation risks. Our catalyst and additionality roles are based to a considerable extent on our reputation and credibility in the marketplace. This reputation is not based exclusively on our financial strength. It also reflects our commitment to the multiple bottom line. Partners expect us to include all stakeholder interests in our investment and/or project decisions. In many respects, they count on our due diligence best practice on social, environmental and governance factors to ensure local communities are consulted, there is no breach of human rights, and the project has potential to improve quality of life. We do not compromise on our high standards, but we recognize that we make choices that may not be appreciated by all stakeholders all the time. We carefully balance interests and may also decide to enter a project that is not regarded as perfect from all perspectives. In such cases, we consider agreement on a solid action plan that will secure improvement to be a good basis for creating development impact as well as for mitigating risk. We are committed to maintaining, protecting and growing our reputation.

Mitigating risks in Tanzanian telecommunications

Having launched as the fifth operator in the market, Celtel Tanzania is now the number two mobile telecommunications provider in Tanzania. Its objective is to bring affordable, reliable, high quality telecoms services to economic and financial centers in the countries in which it operates, with rapid expansion to smaller communities once a critical mass in these centers has been reached. FMO is providing the equivalent of US $20 million in local currency – Tanzanian Shillings – to Celtel to support the expansion of its network in the country. In this first-of-its-kind transaction, Celtel aims to receive as much funding as possible in local currency, with the remainder in US dollars if the local market cannot provide sufficient Tanzanian Shillings.

From a risk management perspective, the local currency transaction reduces the risk of potential currency mismatch, and associated exchange risk for Celtel. The risks for FMO, however, are considerable: high-risk financing products in high-risk countries are an important part of FMO's business, and can also provide high returns.

The social development impact of the project is significant and positive. The company creates direct employment (with a projected increase in employees from 400 in 2005 to over 700 in 2007), while creating indirect employment through suppliers, distributors and dealers of mobile products and services. Increased competition between mobile providers leads to competitive rates for customers and the highest quality of local services.



In it for the long haul –

'harnessing potential for productivity...'

FMO financial overview

	2006	2005*
Balance sheet		**€ x 1 mln**
Net loans	1,130	1,010
Equity investments portfolio	216	128
Shareholders' equity	1,083	950
Debt securities and debentures/notes	1,004	1,139
Total assets	2,306	2,329
FMO Finance committed portfolio	2,735	2,409
of which are government funds	519	350
Profit and loss account		**€ x 1 mln**
INCOME		
Interest income	142	121
Interest expenses	-50	-41
Net interest income	92	80
Income from equity investments	81	11
Other income including services	29	43
Total income	**202**	**134**
EXPENSES		
Operating expenses	47	41
Operating profit before value adjustments	155	93
Value adjustments		
- to loans and guarantees	-8	-13
- to equity investments	2	5
Total expenses	41	33
Share in the results of subsidiaries	4	0
Profit before tax	165	101
Net profit	134	73
Ratios at end of year (percentages)		**%**
Shareholders' equity/total assets	47.0	40.8
Return on shareholders' equity		
- Operating result before taxation	15.2	10.6
- Net profit	12.4	7.7
Net profit/total assets	5.8	3.1
Ratio of operating expenses/income	0.2	0.3
Value adjustments to loans/total loans	11.5	14.6

* Adjusted for comparative purposes

Financial results

While achieving sustainable development impact is our primary goal, continuity in our business cannot be achieved without sound financial performance. In 2006, we achieved further portfolio growth while improving the overall quality of our portfolio. Growth in net profit was once again exceptional at €134 million (2005: €73 million). This performance was driven primarily by results on equity participations and supported by low ‘value adjustments’ (the International Financial Reporting Standards term used in place of ‘provisioning’). Our committed portfolio, including government funds, grew 13% to €2,735 million (2005: €2,409 million), reflecting our strong focus on increasing deal flow and reach.

COMMITMENTS

A record number of total new commitments, including government funds, was signed in 2006 for €937 million (2005: €699 million). New commitments for FMO's own account totaled €731 million (2005: €564 million); new commitments for FMO as fund manager for the Dutch state amounted to €206 million (2005: €135 million). This led to the strong increase in the committed portfolio.

OUTSTANDING PORTFOLIO

Growth of the gross outstanding portfolio (2006: €1,707 million, 2005: €1,538 million) was achieved in spite of a challenging working environment in which the depreciation of the US dollar played a role. Although decreasing gradually over the years, the greater part of FMO's portfolio is still denominated in US dollars. We were also affected by a high number of early repayments due to ongoing positive global economic growth and high liquidity in the commercial banking and investment markets. Nevertheless, because of the high level of disbursements in 2006 of €689 million (2005: €329 million), the positive economic environment and consistent emphasis on intensive portfolio management resulted in a further improvement in the quality of the loan and equity portfolio. The ratio provisioned portfolio/total portfolio both for loans and equity has significantly decreased.

INCOME

Total income increased considerably by 51%, from €134 million to €202 million. The main driver behind this growth is FMO's equity portfolio. From 2000, FMO has been carefully and gradually expanding its equity portfolio based on client demand, strong partnerships and our additionality and catalyst focus. Our experience shows that although equity can be higher risk, there is also potential for higher returns. Add to this the favorable worldwide economic conditions and FMO is ideally positioned to ‘harvest’ returns. This is demonstrated by results from the divestment of, or exit from, equity participations amounting to €74 million, with an additional €10 million from dividends and associates.

Net interest income increased from €79 million to €92 million, because of the increase in the portfolio and increase in interest rates of the treasury portfolio.

Labor conditions high in Indonesian textiles company

Indonesia ranks among the world's top ten textiles and clothing exporters, making the industry an important contributor to the country's economy. Indeed, it is the largest provider of employment and a major source of export earnings. PT Indo-Rama Synthetics is the biggest producer of polyester textiles in Indonesia, employing over 7,500 staff in three plants at Purwakarta, Bandung and Campaka.

High social risk is typical in the Asian textile sector, as inadequate labor conditions are common. FMO was therefore eager to carry out a labor audit to ensure that Indo-Rama was meeting international labor standards. After initial skepticism, the textiles company in fact scored highly in the audit, with only minor, easily mitigated issues identified. Social development impact is also high: as well as creating both direct and indirect employment, Indo-Rama's innovative product technologies contribute to local technological knowledge. Economic development impact is also generated through export income, taxes and improved Indonesian foreign exchange position.

FMO provided a US $15 million loan to the textiles firm as part of a US $40 million syndicated term facility. FMO's part of the loan has a five-year tenor, with three equal repayment installments due during that time. The money will be used to refinance existing exposure and to invest in the ongoing modernization of Indo-Rama's production facilities.

ECONOMIC
SOCIAL
ENVIRONMENTAL

Results from financial transactions in 2006 are considerably lower than in 2005. This is due to increased savings on the funding portfolio in 2005 and the one-off higher income from the first-timer revaluation of the embedded derivatives in the equity and loan portfolio under IFRS.

Besides finance activities from our own resources, FMO manages special government funds for which we receive remuneration. The results from remuneration for services rendered increased to €23.3 million (2005: €22.7 million), reflecting the high level of disbursements by the major funds managed by FMO. Remuneration for the management of government funds is calculated, among others, on the basis of disbursements and level of the outstanding portfolio.

OPERATING EXPENSES

Operating expenses increased 15% from €41 million to €47 million. This increase is driven in part by the structurally higher level of FMO activities, which is also reflected in higher income. Furthermore, we saw an increase in incidental costs, including a one-off write down on software and additional pension plans. If these incidentals are excluded, then like-for-like cost increases would be 9%, reflecting the higher activity level of FMO. The actual cost/income ratio decreased from 30.6% in 2005 to 23.3% in the reporting year.

VALUE ADJUSTMENTS

Provisions (under IFRS 'value adjustments') contribute positively for the second consecutive year. The favorable economic environment and consistent focus on portfolio management resulted in further improvement of the quality of the portfolio. Earlier provisions during economic downturn, especially during the Asia and Latin America crises, have been released and new value adjustments were limited in 2006. The moderate impairments of €2 million (2005: €5 million) taken on equity investments confirms the quality of the current equity participations portfolio. The coverage ratio (value adjustments/portfolio with value adjustments) is 61% (2005: 53%), sufficient to cover FMO's portfolio risk adequately in the current economic environment.

BALANCE SHEET

Total assets remained stable. Portfolio growth was financed by a decrease in short-term deposits. The high level of short-term deposits at the end of 2005 reflected the attractive market conditions for FMO's funding. Our treasury department took the opportunity in 2005 to attract extra funding on the Yen-market under the European Medium-Term Note (EMTN) program against favorable conditions.

From 2000, FMO has been carefully and gradually expanding its equity portfolio, based on client demand, strong partnerships and our additionality and catalyst focus. Our experience shows that even though equity can be higher risk, there is also potential for higher returns. Add to this the favorable worldwide economic conditions, and FMO is ideally positioned to 'harvest' returns.

In 2006, FMO's equity crossed the €1 billion milestone for the first time and amounted to €1,083 million. The equity was increased by the exceptionally high net profit of €134 million. The 'Available For Sale' (AFS) reserve reflects the change in the fair value of the portfolio of equity and interest-bearing securities. The valuation of interest-bearing securities has decreased due to interest rate increases in capital markets in 2006, whereas the fair value of our equity portfolio increased during the course of the year. As a result, the AFS reserve remained the same compared to 2005.

TREASURY

Our treasury department is responsible for providing sufficient liquidity while limiting currency and interest risk. The percentage of the US dollar-denominated portfolio is still high, compared to previous years; it stabilized at 70% in 2006. As we report in euros, we are subject to exchange rate fluctuations that affect the balance sheet. Effects on net profit and equity are largely mitigated since the US dollar-denominated part of our loan portfolio is funded in the same currency.

FMO's EMTN program is an important source of funding. In 2006, eight new notes were issued on attractive terms totaling €75 million; three contracts totaling €18 million were redeemed. The EMTN loans are predominantly converted into variable-rate US dollar funding by means of interest rate and currency swaps.

In addition, derivatives are taken in order to control interest rate and currency risk. At the end of 2006, the nominal value of the outstanding derivatives was €1,113 million.

FMO's AAA rating from Standard & Poor's, supported by the Agreement State-FMO of November 16, 1998, facilitates our funding and supports sourcing from capital markets with competitive conditions.

The financial figures are based on FMO's audited annual accounts 2006 on which KPMG has issued an unqualified opinion (see page 129).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Environmental & social results

FMO integrates the assessment of environmental risks and opportunities into its financing process. In doing so, we do not retreat from projects that may have potentially significant adverse environmental or social impacts, as long as they can be adequately assessed and mitigated. This is why we categorize the potential environmental and social risk profile at an early stage, and target our due diligence accordingly. In 2006, the vast majority of our newly contracted clients fell into category B (see sidebar on page 50: Environmental and social risk categorization). A total of 10 newly contracted clients (less than 10%) qualify as environmental and/or social category A.

In addition to the potential risk categorization of a project, we bring the actual environmental and social performance into the equation, as well as the quality of management and mitigation of these risks. After due diligence, we rate this using our scorecard, and update this annually as part of our monitoring process.

Of the clients contracted in 2004, 72 were still in the portfolio in 2006. Of the latter, in 2004, 46 showed room for improvement on social aspects and this also applied to 49 clients on environmental aspects. This means that these clients did not yet fully comply with all FMO environmental and social standards at the moment of finance approval. Two years later in 2006, 33% had improved on their environmental risk factor and 24% on their social risk factor. For 10% and 4% of them respectively, the score worsened. The majority (57% and 72% respectively) stayed in the same bracket. It can be concluded that real improvements take time, and that a project sometimes deteriorates and requires extra follow-up attention.

Environmental and social risk factor scores are heavily influenced by environmental and social policies and management systems being in place. The effect of our recent emphasis on second-tier companies is noticeable. These companies are generally local, dynamic and young. Complying with international standards is their ambition; in practice these companies often do not yet benefit from the most modern machinery and equipment. Consequently they score, on average, lower on environmental impact than many well-established corporates. A smaller percentage of new clients qualify for positive environmental scores, and a higher percentage fall in the neutral category.

Comparing scores of clients contracted in 2005 with those contracted in 2006 shows too that environmental concerns have a longer history than social issues. Consequently, more financial intermediaries have environmental policies in place than social policies.

As we have only collected data for three years, we have access to limited hard evidence. As the time span of our scores increases to cover more years and the number of projects grows, outcomes will become more meaningful.

Environmental and

Environmental and social risk categorization

The intrinsic risk profile of each project or business is categorized, using a World Bank methodology that is also included in the Equator Principles, and can be summarized as follows:

Category A: potential adverse environmental or social impacts are significant and likely to be irreversible or unprecedented (for instance: mining)
Category B: potential adverse environmental or social impacts are real but site-specific, reversible and can be mitigated (for instance: existing industrial plant)
Category C: potential adverse environmental or social impacts are negligible (for instance: software company)

Once the potential risk profile is established, FMO sets out to assess the risk score of the project, including the level of risk management and compliance with our investment criteria. From this, we allocate an environmental risk factor and a social risk factor, set out in the FMO scorecard and updated annually. A full explanation and detailed outcomes can be found on the FMO website (www.fmo.nl).

In-house environmental management

Although on a minor scale compared to the impact of our financing activities, reporting on our own environmental footprint sends an important signal. FMO's environmental policies reflect our commitment to managing our direct environmental impact. We see minimizing this in very practical terms. At FMO, this meant first determining how our activities affect the world around us. We made an inventory of those activities where we impact. Subsequently, we introduced policies to reduce that impact as much as possible. Further steps are taken every year to ensure FMO gradually reduces its potentially negative impact.

One of our biggest environmental impacts is that the nature of our business and the organizational concentration in The Hague, rather than establishing a global network of offices, requires significant air travel. CO_2 emissions from air travel amount to 1,187 tons (2005: 921 tons). Reducing air travel is hard to manage since face-to-face contact with clients and assessments of their projects are crucial for the quality of our work.

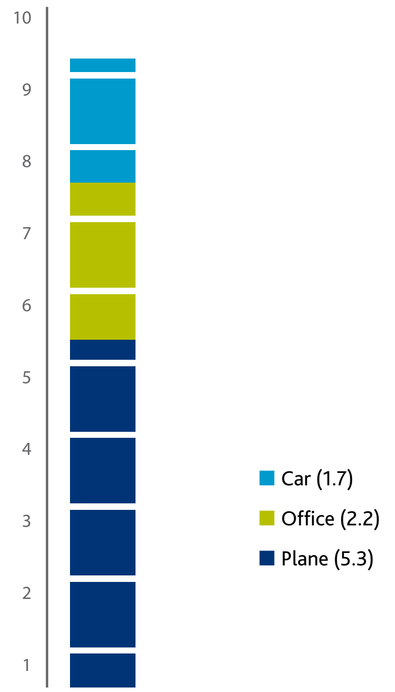
Focus 2007

- FSC certified paper as standard for all office and corporate literature uses;
- power from sustainable sources;
- 20% organic ingredients for our office catering.

In terms of road travel, FMO makes company cars available to some of its employees. We estimate that road travel, mainly commuting to the office, generates 382 tons (2005: 377 tons) of CO_2. However, personnel are encouraged to opt for the alternative to a company car. Of the employees eligible, 19% have opted for a first class public transport card, and 25% for the cash equivalent of the card. Other CO_2 emissions are shown in the graph. We are committed to monitoring and mitigating this negative impact and reporting annually on progress. Since 2004, our goal has been to become CO_2 neutral. In 2006, we achieved 'CO_2 neutrality' by buying 7,013 carbon credits to offset negative impact from both (air) travel and our overall operations over the period 2004-2006.

In 2005, paper was defined as the primary raw material we use. We estimated that every full-time equivalent (FTE) at FMO used 68.3kg in 2006 (2005: 55.2kg). In terms of paper usage per new contract, this decreased from 116.7kg in 2005 to 88kg in 2006. Paper use is thus clearly linked to higher productivity per FTE. In 2006, we introduced new paper usage policies aimed at reducing usage. All printers and photocopiers are now stocked with Forest Stewardship Council (FSC) paper. Standard practice is to print double-sided. From 2007, all FMO literature and corporate materials will be printed on FSC paper by certified printing companies. This move ties in with the sustainable procurement policy put in place in the reporting year. From 2007, we will require our larger suppliers to adhere to specific sustainability criteria in their own processes; their sustainability focus will be a key deciding factor in winning FMO's business.

COMPENSATED CO_2 EMISSIONS IN 2006 (TONS/FTE)



One FMO

There is a very clear FMO mindset and culture. The whole team, approaching 250 FTEs based in The Hague, is committed to FMO's development impact goals, which forms the basis of our culture. This has led to a working framework founded on social, environmental and labor best practices and policies being put in place. Within this framework, our Human Resources (HR) team is tasked with creating and maintaining the essential conditions and context to enable FMO's 'human capital' to pursue our ultimate goal: positive, sustainable impact in developing countries.

ORGANIZATIONAL CHART (AS PER MARCH 2007)

Investment	Corporate	Risk Management & Finance
Nanno Kleiterp Chief Investment Officer	Arthur Arnold Chief Executive Officer	Nico Pijl Chief Risk & Finance Officer
Africa Ruurd Brouwer Director	Human Resources Jan-Thijs Both Director	Investment & Mission Review George Meltzer Director
Asia Wim Wienk Director	Corporate Affairs Philip Rogaar Director	Special Operations Roel Messie Director
Europe & Central Asia Huub Cornelissen Director	Audit, Compliance & Control Joan Melis Director	Legal Affairs Jeannette Franken Director
Latin America & the Caribbean Jacco Knotnerus Director	ICT Vacancy Director	Finance Melchior de Bruijne Director
Private Equity Yvonne Bakkum Director		Risk Management Frank Gosselink Director
Financial Markets Erik van Dijk Director		Mid-Office Angelica Ortiz de Haas Director

Works Council

Steven Duyverman, Chairman
Martijn de Groot, Rianne Heijboer, Alwin Kool, Mariëlle van Luttervelt-Pubben, Els Vegter-van Veggel

Like all organizations, FMO aims to recruit and retain the best people. Knowledge is at the heart of all our activities. FMO people must know and understand the challenges facing our clients in developing countries. They must have considerable financial know-how to structure the tailor-made solutions that meet client needs for long-term finance and investment. They must be committed to what we call the 'multiple bottom line' rather than to financial viability alone. They must empathize with the needs of local communities and other stakeholders. This is the FMO mindset. In return, along with a competitive package, we offer a less tangible, but perhaps more gratifying reward: at FMO, job satisfaction comes to a great extent from knowing that what we do can make a huge difference in the lives of many people in the countries where we work.

Focus 2007

The Business Process Redesign is an ambitious new internal project to improve FMO's administrative business processes and increase efficiency. It is currently in the first phase of implementation and will be audited in the summer of 2007. In addition, the focus will be on:

- implementing training and development through the FMO Academy;
- following up on the Employee Satisfaction Survey on Leadership;
- competency management with respect to career development;
- increased professionalism and teamwork.

THE FMO TEAM

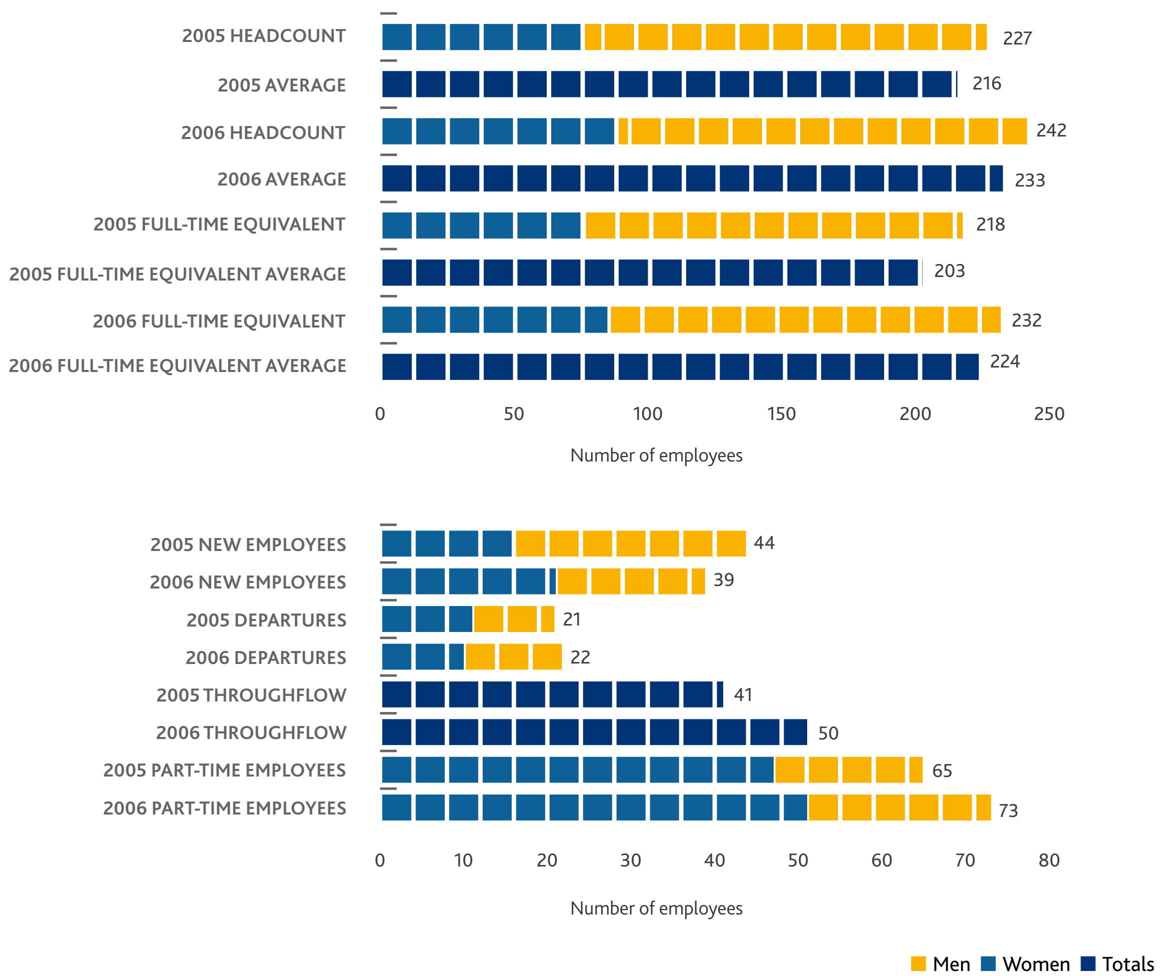
Reflecting our international focus, we are focused on building a team of people of different nationalities. In 2006, the FMO team comprised 12 nationalities. We also aim for a greater gender balance. In 2006, the FMO team comprised 242 (2005: 227) personnel, of whom 38% (2005: 37%) are women. In senior management (members of the MB and directors), 15 out of 17 are male. Our goal is to redress this ratio. The work-life balance is important for FMO and we aim to facilitate flexible working times to accommodate people's family and personal commitments. Of our total team, 169 work full time (2005: 162) and 73 (2005: 65) part time. Absenteeism is at the very low rate of 2.5% (2005: 3.4%).

FMO is committed to achieving bank status. This will ensure FMO's processes are fully integrated and aligned with financial institution best practices. We see this as a driver in an ongoing process to transform FMO from an organization of professionals to a professional organization, or One FMO.

PROFESSIONALIZATION

FMO is committed to achieving bank status. The most significant reason is that bank status will ensure FMO's processes are fully integrated and aligned with financial institution best practice. We see this as a driver in an ongoing process to transform FMO from an organization of professionals to a professional organization, or One FMO. Change is inevitable, especially as we wish to adjust to rapidly changing markets. We aim to make that change organically and over time. It requires full involvement of our employees in

EMPLOYEE RATIOS AND NUMBERS



the process, also through our highly active and committed Works Council. In this way, we ensure our people have a voice in how we make this transformation. With their support, we have already integrated the way our people work together so that we can be even more effective in working with clients. Interaction has been reinforced between front-office employees and specialists who have direct client contact and the back-office employees who create, manage and control the processes and systems that ensure we can deliver to clients. Today, the organization is even better geared to offering the best possible service to our clients.

PERSONAL DEVELOPMENT

This professionalization program continues – it is a living, organic process. Employees at FMO have a Personal Development Program that facilitates this growth. Through regular performance and career development reviews, ongoing individual programs are mapped out.

For HR, it means developing tools to support FMO's ongoing drive to equip our people with the knowledge and expertise they need to do their jobs. Personal and professional development is a strategic issue. We aim to train our people to the highest possible levels while giving them opportunities to gain practical experience in different areas of the business. This can only be achieved if there is real commitment to growing skills. General training efforts focus on key business components, such as social, environmental and governance awareness. 'Know Your Customer' is a program that supports better understanding of our clients and other stakeholders in the local community. At individual level, all employees participate in the 'Operation Shine' initiative: getting the right people in the right place. This is an ongoing process.

INTRODUCING DEVELOPMENT BANKING

In 2006, we initiated a new training program: Introducing Development Banking (IDB) involving 20 to 25 days of training spread over three years. It covers the business aspects, but the main focus is to help our employees gain deeper understanding of what sustainable development impact means for stakeholders. Most of the program is devoted to sharing experiences gained. Making use of the 'lessons learned' database – based on evaluated investments and accessible to all FMO employees – is part of the training program. In the reporting year, 24 participants began the first phase of the program. They were primarily new hires or recent joiners in various disciplines and directorates. This first phase also forms part of the induction for all new front-office employees.

MANAGEMENT DEVELOPMENT

Continuity and the retention of expertise are vital in a knowledge-based organization. This applies to both professional knowledge and skills as well as management competencies. A Management Development Program was initiated not only to pass on know-how, but also to stimulate greater interaction between managers and personnel. In 2005, 18 senior managers started the program. In 2006, the program was extended to a further 25 middle managers, bringing the total number of participants in 2006 to 43.

PERFORMANCE-RELATED PAY

The excellent results in 2006 allowed for an increased budget to reward individual and team performance. 45% of employees received team bonuses, 25% an individual bonus. In addition, all employees will receive a profit-related bonus.

Works Council

Works Council

FMO has an active and committed Works Council. This is where key stakeholders, our personnel, have a voice and can influence the culture and mindset at FMO. It is made up of personnel and acts as an advisory and sounding board for senior management. The Works Council is crucial to our ongoing transformation from an organization of professionals to a professional organization. During the six formal meetings with the Management Board, issues relating to strategy, organizational change, culture and working processes were discussed. Members of the Supervisory Board participated in two meetings. Besides these meetings, there were a number of more informal gatherings where the Works Council were able to offer advice about ongoing changes in the organization, employment conditions, such as pay for performance, pension plan, health insurance, possible changes in policy on absenteeism, job descriptions and evaluations. The Works Council co-hosted a Town-Hall meeting and organized a formal round of employee consultation on the introduction of a new pension scheme.

KPMG assurance on the Report of the Management Board

To the readers of the FMO Annual Report 2006

INTRODUCTION

We have been engaged by Nederlandse Financierings-Maatschappij voor Ontwikkelingslanden N.V. (FMO) to review the Report of the Management Board 2006 (further referred to as the Report) on pages 10 to 55. The Report is the responsibility of the company's Management Board. Our responsibility is to issue an assurance report on the Report.

CONTEXT AND SCOPE

In the Report, FMO reports about the state of affairs within the company and the strategy and policy pursued. Our engagement was designed to provide limited assurance on whether the information in the Report is fairly stated in accordance with section 2:391 of the Netherlands Civil Code.

For the financial data that are derived from the financial statements, we refer to the auditor's report on page 129 of the annual accounts.

We do not provide any assurance on the feasibility of the targets, expectations and ambitions of FMO.

STANDARDS AND CRITERIA

We conducted our engagement in accordance with the International Standard for Assurance Engagements (ISAE 3000): *Assurance Engagements other than Audits or Reviews of Historical Financial Information*, drawing from emerging best practice and principles within international assurance engagements. Among others, this standard requires that:

- the assurance team members possess the specific knowledge, skills and professional competencies needed to understand and review the information in the Report, and that they comply with the requirements of the IFAC Code of Ethics for Professional Accountants to ensure their independence;
- when providing limited assurance, which is a lower level than reasonable assurance, a negative form of conclusion is used.

For the Report, FMO applies the requirements as set out in section 2:391 of the Netherlands Civil Code.

WORK UNDERTAKEN

Our review included the following activities:

- a review of the content of the Report in relation to the requirements as set out in section 2:391 of the Netherlands Civil Code;
- a review of the underlying principles of information management and reporting used in drawing up the Report;
- interviews with relevant staff responsible for the information in the Report;
- a review of internal and external documentation such as minutes of meetings, reports, and intranet sources;
- a review of the underlying systems and procedures used to collect and process the reported information, including the aggregation of data into the information in the Report;
- a review of the reliability of the quantitative and qualitative information in the Report based on sampling.

During our investigation, we discussed the necessary changes in the Report with FMO and determined that these changes have been adequately incorporated into the final version.

CONCLUSION

Based on the requirements as set out in section 2:391 of the Netherlands Civil Code, we conclude that the information in the Report on pages 10 to 55 does not appear to be unfairly stated.

COMMENTARY

FMO has taken an innovative step by obtaining assurance on the Report as part of the Annual Report and combining sustainability information and financial information for the year 2006. In this context, without affecting the conclusions presented above, we would like to draw the readers' attention to the following:
FMO determines the content of the Report based on their knowledge and experience. We recommend FMO to further structure this process, including formalizing issue analysis and selection.

Amstelveen, March 15, 2007

KPMG Sustainability B.V.

W.J. Bartels RA

Making sure change happens –

‘stimulating knowledge and skills through capacity development...’

In Control Statement

Given the inherent high-risk nature of our business and the markets in which we operate, we, the Management Board, are responsible for taking appropriate measures for the design and operation of internal risk management and control systems, and to ensure that these systems are consistent with FMO's objectives and operations. These systems have been designed to detect opportunities and risk on a timely basis, to manage significant risks and to facilitate the achievement of the strategic, operational and financial targets.

During 2006, we systematically analyzed and, where necessary, extended the organization's internal risk management and control processes. In accordance with the Basel Committee's Guidelines for Sound Practices for the Management and Supervision of Operational Risk, we defined an operational risk management framework. Risk and control self-assessments by senior management took place. The conclusions of the assessments are in line with those of the 2005 comprehensive strategic risk assessment. Areas for further improvement relate in general to operational management and the need to strengthen the monitoring of conformity with internal procedures and instructions. The increased focus on this has been complemented by the continuation of the Management Talent and Development Program initiated in 2005, which aims to further enhance staff professionalism, managerial capabilities and the discipline to adhere to sound and safe policies.

FMO implemented new loan administration and accounting systems in 2006. The systems have been set up based on current industry standards and form an important foundation for the proper registration of FMO's operations and the envisioned reporting on Basel II standards in 2007. FMO introduced a new policy framework on compliance and established a compliance organization, including strengthening the staffing of the compliance function. Further, FMO is in the process of implementing the Dutch Central Bank's 'Regeling Organisatie en Beheersing'. We updated and enhanced our Business Continuity Plan, to be finalized in 2007.

The Management Board regularly considers FMO's risk management and internal control practices and discusses all related significant aspects with its senior management. The results of the Management Board's review of FMO's internal risk management and control systems, including changes and planned improvements, have been discussed with the audit committee which has reported these to the Supervisory Board.

Based on our review of the company's risk management and internal control systems, and cognizant of their inherent limitations described below, we have concluded that there is reasonable assurance that:

- we have sufficient insight into the extent to which FMO's strategic and operational targets will be realized;
- FMO's internal and external (financial) reporting is reliable;
- applicable laws and regulations are being complied with.

It is important to note that the proper design and implementation of a risk management and internal control system significantly reduces, but cannot fully eliminate, the possibility of poor judgment in decision-making, human error, control processes being deliberately circumvented by employees and others, management overriding controls, and the occurrence of unforeseeable circumstances. Another limiting factor is the need to consider the relative costs and benefits of risk responses. Properly designed and implemented risk management and internal control systems will therefore provide reasonable but not absolute assurance that a company will not be hindered in achieving its business objectives, or in the orderly and legitimate conduct of its business. In this context, reasonable assurance refers to a degree of certainty that would be satisfactory for a prudent manager in the management of his affairs in the high-risk environment in which FMO operates.

The Hague, March 15, 2007

Arthur Arnold
Chief Executive Officer

Nanno Kleiterp
Chief Investment Officer

Nico Pijl
Chief Risk & Finance Officer

Outlook 2007

Prospects look bright. Expectations are high, markets upbeat. Capital keeps moving around the world in ever-growing volumes. Until the next crisis arrives. Where and when: if only we knew. Despite these positive trends, poverty remains at unacceptably high levels. With our capital strengthened in the past few years, FMO has the financial muscle to mitigate the effects of a crisis, should one occur. We prefer, however, to use this additional financial clout to further intensify our fight against poverty.

As buoyant markets continue to show significant growth, FMO will continue its climb upwards on the risk ladder: equity and mezzanine, least and less developed economies will figure prominently. FMO will have to keep adapting to dynamically changing markets and continue finding new niches, where private-sector players are entering and taking over. In Central and Eastern Europe, this means moving further eastward, in Africa connecting countries and partners, in Asia developing new niches in dynamic environments and in Latin America moving slowly down the market.

For FMO, the end of 2007 will also form a starting point in several respects. The year could be characterized as a year of preparation.

The DII, which has proved a spectacular success in its first phase, will grow and become a fully-fledged sustainability management tool. So far, it measures economic development impact. Within the past two years it has become an effective and fully accepted management tool. It is already impossible to imagine FMO without it. From 2008 onward, the DII will further take into account the social, environmental and governance aspects. The success of the DII demands this next step.

FMO will strengthen its business processes, bringing them into line with national and Basel II standards. FMO intends to apply to the Dutch Central Bank for a bank license. FMO will thus acquire a status which is recognized in the financial world. Supervision by the Central Bank will give both clients and partners even more confidence and strengthen FMO's position as a solid financial institution.

Innovation is a continuous process. In 2007, we aim to give local currency finance a boost through an FMO initiative, supported by the government and by development and commercial institutions. The Currency Exchange (TCX for short), a new multilateral institution, will be created. Affordable housing will generate high development impact in different regions of the world. FMO will use the new Access to Energy Fund from the government to help address the ever-growing demand for financing energy in a sustainable way. FMO is changing the playing field.

Now that the Dutch government has also organized its private-sector policies along infrastructure, financial sector and capacity development axes, FMO will be able to complement government policies even more. At the same time, we will expand our global network of partners as we believe in the power of having many different partners in development, internationally and locally.

Though we do not foresee a crisis in 2007, we find it unlikely that the historical financial success of 2006 will be repeated in 2007. As we are gradually moving into equity and mezzanine finance, we expect our financial results to become more volatile in the years to come.

SUPERVISORY BOARD

WILLY ANGENENT (1940), CHAIRMAN
Willy Angenent serves as Chairman of the Supervisory Boards for FMO, Vedior N.V. and Altera Vastgoed N.V. From 1998 until mid-2000, Mr. Angenent was Chairman of the Board of Management of Laurus N.V. Between 1992 and 1998 he was a member of the Board of Management of Vendex International N.V. He held various positions with Unilever in the Netherlands, Latin America, France and the United Kingdom from 1970 until 1991.

DOLF COLLEE (1952)
Dolf Collee was a member of the ABN AMRO Bank Managing Board. He was a member of the ABN AMRO Bouwfonds Nederlandse Gemeenten N.V. Supervisory Board, a member of the Delta Lloyd ABN AMRO Verzekeringen Holding B.V. Supervisory Board, Vice Chairman of Capitalia Gruppo Bancario (Italy) Board of Directors, a member of K&H Bank Hungary Board of Directors, Chairman of Kobalt Media Services B.V. Supervisory Board and a member of SVM PACT Supervisory Board.

JACQUELINE CRAMER (1951)
Jacqueline Cramer was director of Sustainable Entrepreneurship Strategy & Innovation Consulting and advises business leaders in the area of implementation of sustainable entrepreneurship. Until recently, she was also a professor of sustainable entrepreneurship at the University of Utrecht and a member of the Supervisory Boards for Shell Netherlands, ASN Bank Funds, Dutch Sustainability Research, University of Maastricht and the Hogeschool Arnhem Nijmegen. She has also been a member of the Dutch Socio-Economic Council and a member of the Advisory Boards of the Netherlands Institute for Health and Environment, Dutch World Wildlife Fund for Nature and the Innovation Network on Sustainable Agriculture. On February 22, 2007, Jacqueline Cramer became the Minister of Housing, Spatial Planning and the Environment (VROM). She has therefore resigned as a member of FMO's Supervisory Board.

CEES MAAS (1947)
Cees Maas has worked for ING since 1992. In July 1996 he was appointed Chief Financial Officer and in 2004 became Vice Chairman of the Management Board. Between 1976 and 1992, he worked for the Ministry of Finance, serving as Treasurer-General between 1986-1992. From 1971-1976, he held positions at Erasmus University. He is also Vice Chairman and Treasurer of the Board of Directors of the Institute of International Finance, Chairman of the European League for Economic Cooperation (ELEC), Dutch Chapter, European Treasurer of the Trilateral Commission and a member of the Capital Markets Consultative Group (IMF) and Advisory Board of Rembrandt Society.

LODEWIJK DE WAAL (1950)
The former Chairman of the FNV, Lodewijk de Waal was appointed as the Director General of humanitarian association Humanitas from July 2006. He has more than 32 years' experience with trade union organizations in national and international contexts. He is also member of the Supervisory Board of Delft University, member of the Advisory Council of the Association of Dutch Healthcare Insurers, chair of the governing board of the Netherlands Development Organization SNV, and Chair of the Governing Board of the International Water and Sanitation Centre IRC.

REIN WILLEMS (1945) (AS PER AGM 2006)
Rein Willems has been President of Shell Nederland since October 2003. Since 1969, he has held a number of positions at Shell, with postings in Singapore, Australia, the UK, the Philippines and Brazil. In addition, he is a member of the executive committee and the environmental committee of the Employers Association VNO-NCW and the Innovation Platform, Chairman of the Supervisory Board of Koninklijke Joh. Enschedé, member of the Advisory Board of the Vrije Universiteit Amsterdam and of the Centraal Orgaan Opvang Asielzoekers.

Report of the Supervisory Board

As the Supervisory Board of FMO, we are gratified to report that performance in 2006 has generated strong results both on primary development impact goals and on financial targets. Through this performance, FMO is better positioned to pursue all its sustainability objectives and continually improve its service to clients and partners into the future.

Development impact is the main goal of FMO. In 2005, a benchmark to measure development impact was introduced so that we can monitor FMO's performance on this priority goal. In the reporting year, FMO achieved a DII score of 570 (2005 – base year: 390). To a significant extent, FMO's ability to stimulate and create development impact depends on its ability to generate sound and sustainable financial results. In 2006, FMO once again recorded an historic high with a net profit of €134 million (2005: €73 million). We congratulate all 242 FMO people on this performance.

PROPOSALS AND RECOMMENDATIONS TO THE ANNUAL GENERAL MEETING OF SHAREHOLDERS

FMO's Supervisory Board endorses the report of the Management Board (see pages 10 to 61). We propose that the Annual General Meeting of Shareholders (AGM) adopt the 2006 annual accounts audited by KPMG Accountants N.V. (see page 129). Furthermore, and in accordance with Article 6(2) of the Agreement State-FMO of November 16, 1998, we propose that the AGM approve the allocation of €126.8 million (2005: €69.1 million) to the contractual reserve. The remaining amount of €7.2 million (2005: €4.3 million) is the distributable component of profits. The Supervisory Board recommends that the AGM adopts the Management Board's proposal to pay a cash dividend of €5.44 (2005: €3.25) per share and allocate the remaining €5.1 million to other reserves.
We trust the AGM will also discharge the Management Board for its management of FMO and the Supervisory Board for its supervision during the reporting year.

SUPERVISORY BOARD APPOINTMENTS

Supervisory Board member	Initial appointment	End of current appointment	SB committee membership
Willy Angenent, Chairman Dutch, 1940	2002	2010	Audit committee Selection, appointment and remuneration committee
Dolf Collee Dutch, 1952	2001	2008	Selection, appointment and remuneration committee
Rein Willems Dutch, 1945	2006	2010	Audit committee
Cees Maas Dutch, 1947	1997	2009	Audit committee, Chairman
Lodewijk de Waal, Vice Chairman Dutch, 1950	1996	2008	Selection, appointment and remuneration committee, Chairman

SUPERVISORY BOARD – STRUCTURE

Supervisory Board members are appointed by the AGM according to the profile approved by shareholders in 2005 (please visit www.fmo.nl for full details). An introduction program for new members includes meetings with the Management Board and Works Council. New members further gain insight into FMO's working processes and target markets through discussions with development impact professionals. Special attention is paid to sustainable development and how FMO contributes to leveraging this through its financing. During 2006, the Supervisory Board comprised six members with very specific expertise in areas relevant to FMO's activities; all members were independent with one exception who was a managing board member of our second largest shareholder. The full Supervisory Board is responsible for overseeing and monitoring the FMO Management Board's progress on executing strategy and pursuing medium-term goals. All members are available to the Management Board for strategic advice, with dedicated committees on audit and on selection, appointment and remuneration, able to provide specific advice on related issues.

As per the date of the AGM in 2006, Joop Hoekman resigned as Supervisory Board member after 12 years of service. FMO is grateful for the important contribution Joop Hoekman made to FMO as member of the Supervisory Board and for his work in the various committees, including the project committee, the audit committee and the selection, appointment and remuneration committee. The Supervisory Board is proud that the 2006 AGM appointed Rein Willems, president of Shell Nederland B.V., as Joop Hoekman's successor. Jacqueline Cramer was a member of the Supervisory Board for only nine months, but during this time made a great contribution to FMO's sustainable development goals.

WORKING METHOD

FMO's Supervisory Board and committees work through regular, pre-scheduled meetings, and on an ad hoc basis throughout the year. A transparent formal reporting structure is in place, but Supervisory Board members are frequently in contact with the Management Board so that they remain fully informed and can provide advice at all times; the Supervisory Board Chairman meets the CEO informally once a month. With the exception of evaluations and appraisals, the full Management Board meets the full Supervisory Board at all pre-scheduled meetings. Absenteeism is negligible. At all four pre-scheduled meetings, there are a number of recurring key issues. These include:

- FMO's relationship with the Dutch State which is the majority shareholder and provider of government funds that give FMO its distinct profile;
- progress on strategic goals and objectives, such as development impact and quarterly financial results;
- budgets;
- ongoing development of 'One FMO';
- proposed achievement of bank status and related procedures;
- upgrades in ICT systems.

Furthermore, in 2006, two additional meetings were convened to discuss the possibility of setting up a local currency fund (TCX) as well as FMO's environmental and social policies.

SUPERVISORY BOARD COMMITTEES AT WORK

THE AUDIT COMMITTEE

Comprising Cees Maas as Chairman, Willy Angenent and Rein Willems (successor to Joop Hoekman), the audit committee works according to the charter approved by the AGM. It holds a mandate from, and reports to, the full Supervisory Board (to review the charter, please visit www.fmo.nl). Key issues in 2006 (and continuing in 2007) are the proposed bank status, the audit-related changes and upgrades to working processes and ICT systems. Through the year, the audit committee monitors economic capital issues, in line with Basel II guidelines. It reviews and advises on financial position, operational risks and reporting, corporate governance relating to financials and processes, including compliance, internal and external control and audit reports, and audit-related ICT systems. One meeting, in September, was devoted to first-half performance.

In 2006, the audit committee met three times. The external accountants, internal auditor, Finance Director, CRFO and CEO were present at all meetings. Tasks included reviewing the quality of FMO's financial reporting, cooperation between financial departments and other related financial matters.

THE SELECTION, APPOINTMENT AND REMUNERATION COMMITTEE

Lodewijk de Waal chairs this committee comprising members Willy Angenent, Dolf Collee and, until February 2007, Jacqueline Cramer. In 2006, key issues were the proposed pension plan and a minor adjustment to the remuneration policy for Management Board members that will be proposed to the 2007 AGM. The main issue on this adjustment is the Supervisory Board's proposed discretion on reducing or increasing Management Board members' performance-related pay and its authority to deny the bonus payment altogether in exceptional circumstances. Please see the Remuneration report on page 66 for full details.

At the end of another very strong year for FMO, during which significant growth in development impact has been achieved and financial performance reinforces future sustainable growth, we would like to express our gratitude to all stakeholders in FMO.

Seminar in Latin America: challenges and perceptions

In March 2006, FMO, together with several partners, organized the second in a series of highly successful conferences on financial services in emerging markets. Bringing top players in the finance field to the Uruguayan coastal town of Punta del Este attracted parties from different countries, sectors and banks.

Topics for discussion included the increasing role of Asia, and specifically China, in today's economic markets and the effect of this on competition, strategies and markets. A second discussion subject was recent trends in consumer demand and the consequences of these on production. Given the vast choice consumers are faced with, their perceptions of what constitutes a good product will be based not only on price or service, but on wider issues such as environment, health, labor conditions and animal welfare. A third topic covered private equity and mezzanine finance, particularly in Latin America. Changes in the banking sector, including new regulations, competition and perceptions of risk, are challenging today's businesses and demanding new and innovative types of funds and financial services.

DBA Director Dr. Gert Jan Mulder comments: 'this conference was all about developing meaningful and long-lasting relationships between financial institutions, financial advisors and private enterprises in the Mercosur and elsewhere. We believe we have succeeded in bringing together a highly-motivated group of financiers and entrepreneurs – many of whom were present for the second time – which led to interesting discussions about topics relevant for the businesses of tomorrow'.

Remuneration report

This report was prepared by the selection, appointment & remuneration committee and was approved by the Supervisory Board of FMO. It is based on the remuneration policy that was approved by the Extraordinary Meeting of Shareholders on November 24, 2005. If changes are deemed desirable, they will be submitted to the Annual General Meeting of Shareholders (AGM) for approval. This report addresses the remuneration specifics for 2006 and the way the policy will be pursued in 2007 and beyond.

REMUNERATION POLICY

The purpose of the remuneration policy is to attract, motivate and retain qualified people who will contribute to the success of FMO, including Supervisory and Management Board members. All personnel is employed in accordance with the General Bank-CAO (Collective Labor Agreement). The terms of employment of Management Board members are to some extent different. Remuneration levels are in line with prevailing market conditions and are based on responsibilities, experience and performance of the individuals concerned.

Every year, the Supervisory Board's selection, appointment & remuneration committee advises on remuneration of the Management Board. Based on this advice, the Supervisory Board annually considers and decides on the remuneration package of the Management Board members. The remuneration of the Supervisory Board is determined by the AGM based on a proposal by the Supervisory Board. This working method fully complies with the Dutch Corporate Governance Code.

REMUNERATION OF THE MANAGEMENT BOARD

The remuneration policy for Management Board members is to provide a package that attracts and retains capable executives with relevant expertise in international finance. The Hay Group evaluates the compensation package at least every three years using data from a number of financial institutions in the Netherlands as reference. The remuneration of individual Management Board members (see page 67) for 2006 was adjusted as per April 1, 2006, based on the March 2006 assessment.

REMUNERATION ELEMENTS

The Hay Group monitors developments in the remuneration market for financial sector executives in the Netherlands and advises FMO's selection, appointment & remuneration committee. Remuneration elements include a fixed annual salary, performance-related pay, contribution to pension plan and other components.

FIXED SALARY

For the fixed salary component, the job function is graded according to Hay points. Based on this grading, the median remuneration scale level is then applied. The fixed salary component of the remuneration package is assessed at least every three years, the last of which was in November 2005.

PERFORMANCE-RELATED PAY

This remuneration component consists solely of short-term variable salary in the form of performance-related bonuses according to a system effective as of January 2003 and accepted by the General Meeting of Shareholders on November 24, 2005.

Financial targets are proposed to the Supervisory Board annually by the selection, appointment & remuneration committee, based on the budget of that year as approved by the Supervisory Board at the start of the year, and assessed at the start of the following year. Financial targets relate to business volume, value adjustments, operating expenses, and profit before value adjustments and taxes. The committee advises the Supervisory Board as to whether targets have been achieved and asks external auditors yearly to verify the relevant calculations. In addition, a number of non-financial targets are formulated each year. These targets relate to issues requiring special management attention during the reporting year. In 2006, key issues included further increase of the Development Impact Indicator (DII), improvement of measured customer satisfaction on specific issues, implementation of new information technology on finance and administration, and improvement of management skills and entrepreneurial leadership throughout the organization. Both 'at-target' and 'outperformance' (a predetermined percentage above target) scores have been established. For Management Board members, the total at-target (financial and non-financial) score amounts to 12% and the outperformance score to 20% of the total fixed income. In the case of the Chief Executive Officer, these figures are 15% and 25% respectively.

PENSION SCHEME

As a result of a change in attitude in the Netherlands towards retirement schemes, the Supervisory Board was tasked with bringing Management Board pension plans into line with recent industry developments. These changes relate specifically to the two statutory directors who had been employed by FMO before joining the Management Board. The Supervisory Board agreed with two statutory directors to change their pension plan to an average wage level arrangement in conformity with FMO's collective labor agreement. This arrangement was implemented as per January 1, 2006.

OTHER COMPONENTS

Other employment benefits include a fixed expense allowance, contributions to company cars and a compensation of interest on mortgages. All of these benefits are taxable and apply also for other personnel.

REMUNERATION OF THE SUPERVISORY BOARD

FMO does not compensate members of the Supervisory Board with performance-related pay, shares or loans. At the AGM on May 18, 2005, a revised annual remuneration of Supervisory Board members was approved, effective as per May 18, 2005.

Role	Remuneration (€ x 1,000)
Supervisory Board: Chairman	20
Supervisory Board: Member	12.5
Audit committee: Chairman Audit committee: Member	3 2
Selection, appointment & remuneration committee: Chairman Member	 2 1

On December 31, 2006, the Supervisory Board consisted of six members. The members of the Supervisory Board were paid a total remuneration of €94,500 (2005: €106,000).

REMUNERATION OF THE MANAGEMENT BOARD

The Management Board consists of three statutory members. Their remuneration for 2006 is €1,010,000 (2005: €936,000) and is specified in the table below.

Similar to all FMO personnel, Management Board members further received a one time only payment of 1.75% of annual income on April 1, 2006.

FMO intends to continue the current remuneration policy into 2007 and beyond. However, the Supervisory Board will put forward one amendment to the remuneration policy for approval to the AGM on May 16, 2007. The proposal consists of including a Supervisory Board's discretion on reducing or increasing Management Board members' performance-related pay. The proposed amendment reads as follows:
'In special circumstances, the Supervisory Board has the discretionary power to increase or decrease the Management Board's bonuses within the limits of the aforementioned outperformance scores policies, by a maximum of 5% of total fixed remuneration. If the Supervisory Board makes use of this power, this shall be properly communicated and motivated in the AGM. In exceptional circumstances, the Supervisory Board may also decide not to grant a bonus at all.'

REMUNERATION MANAGEMENT BOARD

€ x 1,000	Fixed remuneration[1]	Performance-related pay	Pension	Other [2]	Total 2006	Total 2005
Arthur Arnold	265	65	72	19	421	404
Nanno Kleiterp	198	40	46	17	301	291
Nico Pijl	176	36	59	17	288	241
Total	**639**	**141**	**177**	**53**	**1,010**	**936**

[1] Members of the Management Board have no shares, options or loans related to the company.
[2] Includes fixed expense allowance, contribution to company car and a compensation of interest on mortgages.

Corporate governance

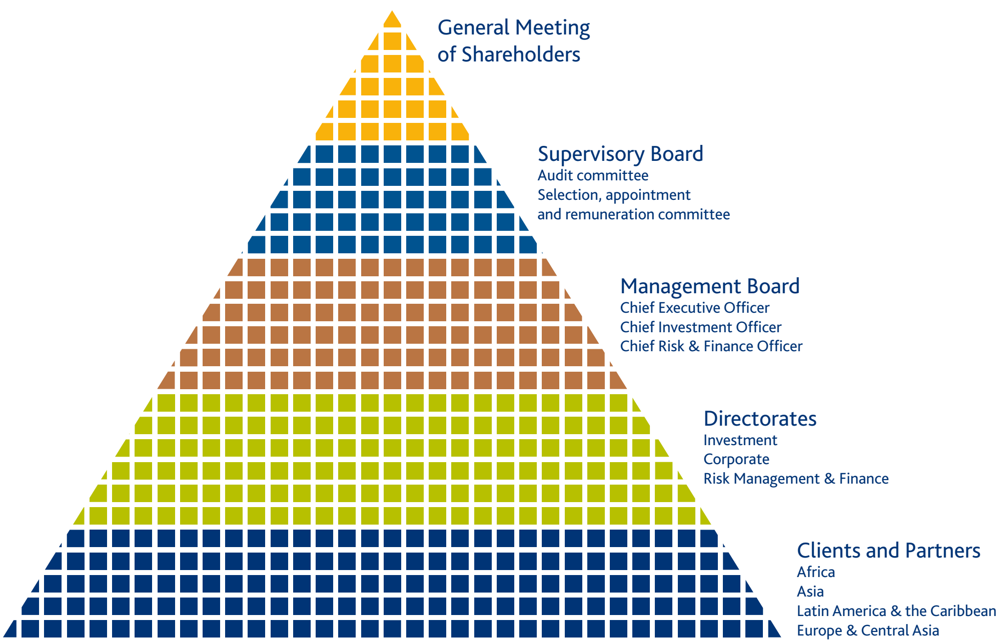
Sound corporate governance is a crucial component at FMO for two reasons. As a public-private development bank, our own governance, structure and reporting lines must be both sound and transparent. This is why we comply, where applicable, with the Dutch Corporate Governance Code (the Code) for publicly listed companies. The second reason relates to our mission to stimulate sustainable growth for all stakeholders in order to maximize development impact. FMO often plays a pivotal role in embedding sound corporate governance in our partners' and clients' own organizations.

The current corporate governance structure was approved by the Annual General Meeting of Shareholders (AGM) in 2005. Any material changes to the existing structure will be submitted for approval to the AGM. The structure is based on the premise that FMO is a long-term partnership of stakeholders who, directly or indirectly, influence or are influenced by the achievement of our objectives. Stakeholders include employees, shareholders and other capital providers, clients and partners, the Dutch government and local communities in the countries where we work.

Our whole organization is expected to take the interests of all these stakeholders into account at all times. In governance terms, this expectation is expressed through the responsibilities and accountabilities of the Management and Supervisory Boards to our shareholders and other stakeholders.

GOVERNANCE STRUCTURE

FMO has a two-tier board structure: the Management Board and the Supervisory Board, as defined by the Netherlands Civil Code. Both boards report directly to the AGM.



ROLE OF THE ANNUAL GENERAL MEETING OF SHAREHOLDERS

The AGM has core powers, including but not limited to decisions on statutory changes, legal mergers, and the adoption of the annual accounts. From a governance perspective, it has power of appointment of members of the Management and Supervisory Boards upon nomination by the Supervisory Board. The AGM may not dismiss or suspend individual members of the Supervisory Board. It can, however, retract its vote of confidence in the entire Supervisory Board, leading to immediate dismissal of all its members. The AGM also approves the remuneration policy for the Management Board and compensation for the Supervisory Board. The AGM is convened once every year. However, both the Management and Supervisory Boards can request extraordinary meetings. Shareholders representing at least 5% of FMO's issued capital can also convene a meeting. In 2006, the AGM was held on May 17. Minutes of this meeting can be found on our website, www.fmo.nl.

ROLE OF THE SUPERVISORY BOARD

The Supervisory Board appoints members of the Management Board, though dismissal can take place only after a hearing at the AGM. As its name suggests, this board supervises the activities of FMO's Management Board. However, it also provides expertise-based advice on the management and (strategic) development of the company. The Supervisory Board consists of five members (following the resignation of Jacqueline Cramer on February 22, 2007) with very specific expertise in FMO's focus areas (see biographies on page 62 and review profile on our website, www.fmo.nl). The FMO Works Council recommends the nomination of one third of the members.

SUPERVISORY BOARD COMMITTEES

As approved by the AGM and included in FMO's articles of association, the Supervisory Board has two dedicated committees – the audit committee and the (combined) selection, appointment and remuneration committee – operating under the overall responsibility of, and reporting regularly to, the Supervisory Board. Committee members are selected based on the relevance of their experience.

A summary of committee activities and accountabilities is on page 71; to review the full role and competencies of these committees, please visit www.fmo.nl.

Capacity development raises the corporate governance bar in Armenian banks

The banking system in Armenia suffers from the absence of comprehensive risk management and corporate governance frameworks. Since 1994, the Central Bank of Armenia has been implementing a series of measures aimed to strengthen banking sector supervision, enforce penalties for non-compliance with norms and requirements, and establish other procedures to improve corporate governance in the financial sector.

In collaboration with NFX (Netherlands Financial Sector Development Exchange), FMO's Capacity Development Fund is financing a project to set the wheels of this implementation phase in motion. The project reports on the current corporate governance and risk management performance of selected banks against best practice benchmarks.

The next step is to put the results of the report into practice. This includes training employees in both the Central Bank of Armenia and other Armenian commercial banks on corporate governance and risk management performance in line with international laws and standards. At a later stage, the aim is to create 'market showcases' of one or two banks focused on implementing sound risk management and corporate governance practices. The result? A more competitive financial sector, which is more attractive to foreign investment.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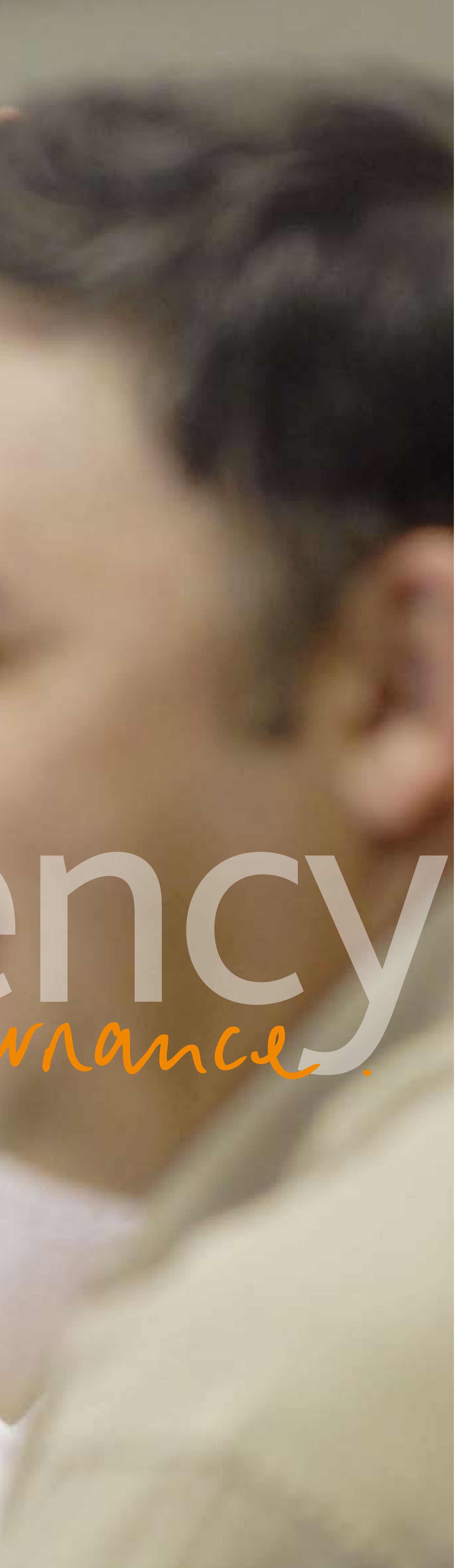

AUDIT COMMITTEE

Reporting regularly to the Supervisory Board, this dedicated committee supervises and advises the Management Board on FMO's financial position. It monitors and offers expert advice on issues such as our risk management policy, internal and external auditing systems and compliance with legislation and external and internal regulations. One of its key tasks is to monitor the performance of external auditors.

SELECTION, APPOINTMENT AND REMUNERATION COMMITTEE

Proposals on the appointment and re-appointment of Supervisory and Management Board members is one of this committee's main tasks. Others include monitoring the remuneration policy, preparing proposed adjustments and giving advice on the remuneration of individual Management Board members.

ROLE OF THE MANAGEMENT BOARD

Comprising three statutory directors – the Chief Executive Officer (CEO), the Chief Investment Officer (CIO) and the Chief Risk & Finance Officer (CRFO) – the Management Board is charged with developing and implementing FMO's strategy. It is responsible for management of, and compliance with, legislation and regulations, such as the implementation of internal risk management and auditing systems.

While the Management Board is accountable, in practical terms, FMO is a flat organization. All our activities are based in, and directed from, The Hague; there are no 'subsidiaries' around the world. This enables us to manage our business in a very integrated and transparent way; reporting lines are short and clear, facilitating supervision and control. As the graphic (on page 68) shows, our governance reporting structure covers not only the roles of the AGM and Management and Supervisory Boards. We impose specific corporate governance requirements on all transactions with our clients and partners. These are incorporated in the processes applied by all our investment officers when negotiating contracts. Governance components are integral to investment proposals submitted to the Management Board for approval. In this sense, our governance structure goes further than the internal organization as it is a key component in achieving our sustainability and development impact goals.