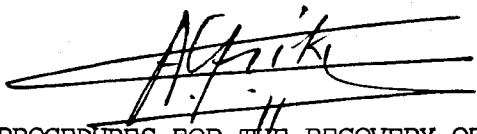


MEMORANDUM

TO : THE BOARDS OF DIRECTORS

FROM : *For* B. NDIAYE  
President 

SUBJECT : POLICY AND PROCEDURES FOR THE RECOVERY OF ARREARS ON LOANS

1. INTRODUCTION

1.1 During its December 1988 meeting, the Boards considered documents (ADB/BD/WP/88/24 - ADF/BD/WP/88/30 and (ADB/BD/WP/88/116) - ADF/BD/WP/88/121) on loans arrears and the sanctions policy of the Bank Group. Following this, the Boards requested Management to revise the said documents by incorporating new aspects therein in line with their observations.

1.2 The Boards will recall that procedures for the recovery of arrears on loans granted by the Bank Group were last updated in 1985. The new procedures then adopted became operational and came into effect retroactively from 1 January 1985. The present memorandum contains the draft update of those guidelines. It takes into consideration the ADB Group's four years' experience in their application, the recommendations made during the December 1988 Boards' meeting, the sanctions policy of other MDBs, and the various constraints of the other parties involved in the implementation of projects and programmes financed by the ADB Group.

1.3 By explaining its objectives, this document gives reasons for the sanctions policy and the setting up of a warning system for improving the recovery of arrears.

2. 1985 DIRECTIVES

Objectives

2.1 The Directives approved in 1985 were mainly aimed at speeding up debt recovery. In other words, the implementation of this system should have led to the reduction in the amount of arrears in the Bank Group's portfolio.

2.2 The introduction of this system was to be accompanied with organizational and administrative measures aimed, among other things, at:

- a) strengthening efficiency, monitoring and follow-up by the Disbursements Department (presently FDIS department) as well as loan administration and the billing system;
- b) improving coordination between various departments involved in disbursement and recovery;
- c) making Executive Directors participate actively;
- d) intensifying dialogue with borrowing countries.

### Principles of the mechanism

The sanctions mechanism revolves around the following main ideas:

- a) debtor: The sanction affects the Borrower or the Guarantor in default of payment of maturities. Every Borrower suffers the effect of sanctions alone without extension to any other Borrower.
- b) gradual character: The sanctions are gradual:
  - firstly, prohibition from signing any new loan agreement;
  - secondly, suspension of disbursement in respect of a specific loan;
  - thirdly, total suspension of disbursements and granting of new loans.
- c) maturity of payments: The different types of sanctions are applied following the maturity of payments due
  - arrears of more than 3 months: prohibition from signing any new agreements;
  - arrears of more than 6 months: suspension of disbursements in respect of the loan in question - or total suspension if one of the loans to the borrower has been fully disbursed;
  - arrears of more than 9 months: total suspension of disbursements and granting of new loans.
- d) cross-default: When one of the three institutions of the ADB Group (ADB/ADF/NTF) totally suspends its disbursements, the cross-default rule automatically comes into effect on disbursements from the other two institutions.
- e) cost overruns: Generally, the ADB Group does not finance cost overruns resulting from the application of sanctions. However, in exceptional cases, the Board of Directors could study and take into consideration recommendations from Management for financing of cost overruns.
- f) exemption: Suspension of disbursements does not affect multinational projects. Loans for preinvestment studies financed from the resources of the Technical Assistance Fund are also exempt from sanctions.
- g) information: The ADB Group should inform the borrower of sanctions which shall be (or are) imposed due to default in payment. In case of suspension of disbursements, it should also inform the cofinanciers as well as all the suppliers of goods and services concerned.

2.4 Due to the various implications both for the ADB Group and others, the satisfactory implementation of such a system is a very complicated and, qualitatively speaking, exacting operation.

### 3. PRACTICES OF OTHER MULTILATERAL DEVELOPMENT BANKS (MDB)

3.1 Sanctions policy is practised by all Multilateral Development Finance Banks and Institutions. Management contacted them for necessary information on their policies and procedures. The InterAmerican Development Bank which recently (15/9/88) revised its policy and procedures for collecting loans arrears sent detailed information. Its policy and procedures are summarized hereunder.

#### Payment

3.2 The only acceptable form of payment is the confirmation that IADB's account had been credited. The previous practice of accepting the written notice of fund transfers from the Central Bank was abolished, since that had led to much misunderstanding.

3.3 A Borrower is considered to be in arrears if, at the date when the arrears is due, no payment had been made into IADB's account (the Finance Department (FD) determines whether the borrower has arrears to settle or not). For this purpose, the FD publishes a weekly report on the "Status of arrears on loans" for reference purposes. This report which is widely circulated within the IADB, is published every Friday and lists all arrears outstanding as at Wednesday of the previous week, taking into account all payments made up to the eve of the publication.

#### Application of arrears recovery procedures

3.4 From the first listing in the report of a loan in arrears, the FD notifies the Borrower concerned by telex that the Bank had not received a given payment due and that if the said payment is not made, suspension measures in line with the general conditions stipulated in the loan Agreement shall come into effect. The FD also informs the Guarantor of the borrower's arrears.

3.5 As soon as the Borrower is listed in the report;

- a) no loan proposal from the borrowing member country shall be presented to the Board of Directors for approval;
- b) the Bank shall sign no loan agreement with a Borrower from the country in question.

These two measures may only be abrogated when all the arrears are settled by the eve of either the Board of Directors' meeting or the signing of the contract.

#### Arrears of 30 days or more

3.6 Thirty days after arrears are due, the FD prepares for the Vice President's signature:

- a) a notice of immediate suspension of disbursements to the Borrower of the said loan or of all other loans;
- b) a notice to the Guarantor requesting prompt payment of all accumulated arrears on the loans.

3.7 The FD may make few exceptions when,

- a) the payments are due in currencies generally not available in the international finance markets at the time the arrears are due (but not when the problem is merely routine); or
- b) the amount due does not exceed 30,000 dollars; or
- c) it is satisfied, based on information from financial institutions involved in the transfer of funds, that the payments are underway.

Arrears of 120 or more days

3.8 As soon as there are accumulated arrears of more than 120 days, the FD notifies the Coordinating Committee in writing. The latter decides to,

- a) suspend all disbursements to the Guarantor of loans granted to it;
- b) suspend the submission of loan proposals from the country in question to the Loans Committee or to the Board of Directors.

Arrears of 180 or more days

3.9 When the arrears are more than 180 days, the FD no longer computes interests on all loans to the Borrower and on all other loans to the country in question. The Vice-President sends a notice by telex to the country's Authorities stating that:

- a) its loans arrears are more than 180 days;
- b) all Bank missions to the country in relation to loans programming, preparation and advice are suspended;
- c) the Bank's regional office would not accept new disbursement applications from the Borrower or its Guarantor on any loan.

3.10 As long as the interests on a loan are not computed, the legal Department makes no amendment whatever to any loan agreement of the affected Member Countries.

Waiver of the Suspension of disbursements

3.11 Disbursements are normally not suspended in the case of:

- a) special commitments - particularly disbursement guarantees;
- b) non-refundable and conditional technical assistance expenses;
- c) operations undertaken as part of the IADB's programme for financing small projects;
- d) direct payments to IADB from loan amounts.

3.12 In all MDB, applications received by regional offices or the headquarters, as the case may be, after the date of suspension of disbursements, are not considered. However, it would seem that the World Bank intends to introduce the clause of paying for works undertaken and supplies made before the date of sanctions in the next revision of its policy.

3.13 The measures considered in this section show that the policies and procedures on the recovery of arrears in other MDBs are stricter than those of the ADB Group.

#### 4. PERFORMANCE

4.1 The performance of the sanctions system is analyzed through the changes, volume structure and age of arrears, their recovery rate as well as Borrowers' behaviour during the period 1985-1988.

4.2 According to Table I hereunder, arrears in the three institutions (ADB/ADF/NTF) grew considerably between 1985 and 1988. During this period, their growth rate stood at 125% for the ADB, 100% for the ADF and 29.4% for the NTF. However, correspondent banks were sometimes slow in forwarding repayments. The non-mastery of this situation partly weighs heavily on the volume of arrears as reflected in the foregoing analysis.

4.3 However, if the volume of arrears is compared with loans granted (disbursed un-refunded loans), the ADB and the ADF appear to have kept their arrears within reasonable limits: for the ADB, 3.2% in 1985, 3.7% in 1987 and 3.6% in 1988, and for the ADF, 0.16% in 1985, 0.13% in 1987 and 0.16% in 1988. On the other hand, for the NTF, a much higher arrears rate could not be avoided. (See details in Annex Page 1).

Table 1

Evolution of Arrears as at 31 December

(in BUA million)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
ADB	32.41	37.08	57.81	73.35
ADF	1.41	1.64	1.90	2.82
NTF	2.51	2.01	2.94	3.25

Composition of arrears according to their age

4.4 Generally, the age of arrears in the three institutions ranges from 6 to 9 months or more as at 31 December of each year. In Table 2 (Annex Page 2), though, the composition and evolution of arrears according to their age differ from one institution to another. There is a general trend in the increase in the number of the oldest arrears in the loans portfolio.

4.5 Arrears of 9 or more months are in the majority in NTF loans portfolio; such arrears also progressively increased in ADB loans portfolio from 40% in 1985 to 55% in 1988. For ADF - TAA loans, arrears of the same age represent one third of the total volume in 1988, but their share has been increasing steadily.

Recovery

4.6 The recovery rate (repayment/billing) in the three institutions presents erratic curves but with a tendency towards stabilizing at about 79.8% for the ADB, 85.2% for the ADF and 67.3% for the NTF. In considering the growth in the amounts due during this period (Annex page 2), the stability of the recovery rate portrays that the Bank Group had redoubled its effort at arrears recovery.

Table 2

Evolution of the Recovery Rate

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
ADB	79.7%	82.8%	77.7%	79.0%
ADF	85.2%	84.7%	86.5%	34.7%
NTF	56.5%	76.1%	66.9%	70.0%

Change in Borrowers' behaviour

4.7 The grouping of Borrowers according to age of arrears permits an assessment of Borrowers' behaviour in relation to the different types of sanctions. Borrowers may, therefore, be classified under two extremes, namely:

- those who pay their arrears before the coming into force of the first sanction (arrears of 3 months) are considered as being very sensitive to the sanctions system;
- on the contrary, those who wait till the application of the third sanction before settling their arrears are identified as being indifferent to the system.

Table 3

Number of countries according to the maturity of payments

	<u>6 months</u>	<u>9 months</u>
1985	27 countries + multinationals	13 countries + multinationals
1988	26 countries + multinationals	9 countries + multinationals

4.8 For the ADB Group as a whole, the number of countries affected by sanctions for arrears of 6 months remained unchanged between 1985 and 1988 while the number of those affected by the third sanction (9 months or more) fell from 13 countries in 1985 to 9 countries in 1988. The reduction in the number of countries affected by the third sanction equally applies to the ADF (8 countries in 1985 as compared with 3 in 1988) and the NTF (7 countries in 1985 as against 1 in 1988). For the ADB, the number fell from 9 to 7 countries during the same period.

Table 4

Concentration of countries in arrears of 9 or more months

	<u>1985</u>	<u>1988</u>
ADB	6 countries (86%)	4 countries (94%)
ADF	spread out among 8 countries	3 countries (100%)
NTF	3 countries (82%)	1 country (100%)

4.9 The strong impact of the third sanction can be seen in the concentration of arrears of 9 or more months on a few countries. In 1988, 4 countries accounted for 94% of arrears of 9 or more months on the ADB loans; in 1985, 6 countries accounted for 86%. For the ADF and the NTF, this concentration is even higher, with 13 countries accounting for 100% of the

arrears in the former, and 1 country accounting for 100% of the arrears in the latter, in 1988. On the contrary, the first and second sanctions seem not to produce the same effect on Borrowers. There is a tendency toward an increase in the number of countries affected by these two types of sanctions in all the three institutions (Annex page 4).

4.10 The differences observed in the change in the total amount of arrears and in the distribution according to their age may lead to a controversial interpretation of the impact of the sanctions system. However, the stabilizing of the recovery rate and the obvious improvement in Borrowers' behaviour in regard to the 3rd sanction show that these are aware of the system's role and of its positive impact. This system may rightly be seen as the instrument which puts a halt to the most negative behaviour by most borrowing countries confronted with economic and financial difficulties.

## 5. IMPACT AND PROBLEMS OF THE 1985 GUIDELINES

5.1 The impact of the sanctions system will be analyzed purely in relation to the various parties involved in ADB Group's lending operations, namely, the fund donor (the ADB Group), the Borrower (the State or other legal entity), where necessary, other cofinanciers, as well as the third parties (enterprises, suppliers, consultants...) involved in the implementation of development projects and programmes.

### Impact of sanctions on the ADB Group

5.2 The impact of the sanctions system is mostly felt in Bank Group finances, lending operations and administration. An unfavourable change in arrears automatically has direct negative impact on such financial aggregates as net income, liquidity and financial credibility.

5.3 Although the loans income from ADF and NTF overall income remains relatively low (24% and 18% respectively in 1987), the presence of arrears on the financial charges over a long period should normally lead to a reduction in income from loans.

5.4 The liquidity policy of the 3 institutions takes into consideration the amount of disbursement independent of their age; a net difference between estimates and receipts creates financial tension.

5.5 ADB's financial credibility depends on its position as a choice creditor to borrowing member countries. However, increase in arrears contributes to eroding this position by creating doubts in the financial market as to ADB's management capacity. This would logically weaken the Institution's financial credibility, leading to increase in borrowing costs and, consequently, in interest rates payable on loans. Such unfortunate situation would lead to reservations on the part of State participants and fund donors during the replenishment of concessional resources (ADF, NTF).

5.6 Since it contributes to decreasing the volume of arrears, the sanctions system has a positive effect on the three institutions. The creation of a specific mechanism for each institution is not borne out since the end result will be similar, and the mutuality of the three institutions is undeniable.

5.7 The operational programmes suffer the negative impact of sanctions in the approval, signature and disbursement of loans. However, beginning with the 1985 guidelines, the negative impact of sanctions on the annual lending programme has been minimized by shifting the suspension of granting

new loans to the third sanction (arrears of 9 or more months). However, it is mostly in its disbursement targets that the ADB Group greatly suffers from the negative impact of sanctions.

5.8 Operational performances (number of approved and signed loans and disbursements) show that over the past four years, the ADB Group has succeeded in containing the negative effects of this system.

5.9 A satisfactory application of the sanctions system brings positive results on organization and administration. It enables the drawing up of clear, consistent and harmonious administrative procedures wherein the role of each organizational unit is defined. It encourages the evaluation and introduction of staff and materials necessary for ensuring the follow-up, monitoring and making estimates of billing, repayments and arrears.

5.10 Management is of the view that the sanctions system is an instrument with many positive aspects which should be maintained all the while updating it in order to keep its secondary negative effects at the minimum.

#### On the Borrower

5.11 In regard to the impact on the Borrower, Management noted that the sanctions policy had a negative impact on the development planning process of borrowing countries, since countries in arrears and under full sanctions can no longer view the loans earlier approved for them by the Bank Group as a source of resources to be used for planning purposes.

5.12 Sanctions can also disturb the implementation of, and expected benefits from, projects. While under sanctions, cost overruns occur which force the country to apply for supplementary loans in order to fully implement its projects after sanctions would have been removed.

5.13 In some cases, sanctions are due almost entirely to a project's late implementation. Consequently, disbursements of a given loan go hand in hand with its repayment. This makes debt servicing heavier on the Borrower who, for that reason, merits special consideration.

5.14 Though borrowers have had to bear the negative effects of sanctions, it should be pointed out that the net resources flow has remained generally positive in the ADB Group as a whole (Annex page 6). Management is of the view that the inclusion of such an indicator per country has become necessary as part of the operational programming.

Table 5

#### Evolution of net resources flows of the ADB Group (in BUA million)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Disbursement	483,52	549,40	666,20	867,13
Repayment	66,32	87,14	95,53	127,29
Total net flows	<u>417,20</u>	<u>462,26</u>	<u>570,67</u>	<u>739,84</u>
	=====	=====	=====	=====



### On the third party

5.15 Sanctions have an unfavourable impact on enterprises and individuals that handle the implementation of a project or programme whose loan disbursement is under suspension. The inability of the borrower to honour his contractual commitments to enterprises could put some of them in a difficult and delicate situation.

5.16 To save themselves from the risks of being financially grounded, enterprises tend to inflate their bids for contracts financed by the ADB Group. Management is of the view that this situation and its effects should be taken into consideration when updating the sanctions system.

### On Cofinanciers

5.17 The sanctions system can slow down the approval of all loans to a project financed by many fund donors. It can also slow down the project implementation as a result of the suspension of disbursements by one of the fund donors.

5.18 In the absence of a system for coordinating sanctions applied by all the fund donors to a given project, Management is of the view that the sanctions system of the ADB Group should continue to be in force, all the while searching for a case by case harmonization with other fund donors.

## 6. PROBLEMS AND PROPOSALS

6.1 During the 1985 to 1988 period, experience has led to the identification of certain weaknesses in the arrears recovery policy.

### Borrower

6.2 Though the 1985 Guidelines had made a distinction between a country and a Borrower, the application of the guidelines has sometimes made no such distinction by applying sanctions against the government even though the Borrower in arrears was, for example, a development bank, and vice versa. Though such confusion has been considerably minimized, steps should be taken to avoid such errors altogether.

### Proposal 1

6.3 To eliminate the confusion described in 6.2 above, "the status of arrears on loans" shall clearly indicate the arrears per borrower and per loan. Notification of arrears and sanctions to each borrower should be clearly spelt out.

### Guarantor

6.4 In the present guidelines, the application of sanctions simultaneously affects the Borrower and the Guarantor. This situation has also been one of the reasons for the confusion described earlier.

6.5 Proposal 2: The Guarantor shall be informed at the same time as the Borrower of the latter's arrears. However, notification of the application of a sanction against the Guarantor due to default of payment on the part of the Borrower shall only be sent after a specified period.

Payment

6.6 The payment of arrears due is acknowledged by confirmation of payment into an ADB Group's account. The ability of the ADB Group to establish the status of arrears is the result of deadlines and administrative procedures established by correspondent banks on the one hand, and the efficiency and rapidity of its own administration on the other hand.

6.7 Management has noticed the late confirmation of some payments announced by Borrowers and Executive Directors. This seems to be due, among other things, to:

- i) payment orders given by the Borrower but not executed by the Central Bank's correspondent bank due to insufficient funds;
- ii) imprecise payment orders given by the Borrower makes their application difficult;
- iii) administrative delays sometimes from officers of correspondent banks.

6.8 Proposal 3: The proof of payment shall be the confirmation of payment into an ADB Group account.

6.9 Proposal 4: Based on information supplied by a reputable bank to the Borrower's Central bank, FDIS shall recommend to FNVP to take into consideration an unconfirmed payment.

6.10 Proposal 5: After giving a go-ahead order to pay the ADB Group, the Borrower shall inform ADB Management by telex stating the payment references, the amount and its purpose, the executing bank and the effective date of the operation.

6.11 Proposal 6: The ADB Group shall establish with correspondent banks a system for fixing the effective date for payments made and the penalty rate payable in case of failure to respect deadlines. The penalty shall be paid into the Borrower's loan account.

Status of arrears on loans

6.12 The document "Status of arrears on loans" issued monthly by FDIS to the Board is an information note without direct reference to sanctions. The application and removal of sanctions are contained in the memoranda published by FDIS. Such procedure necessitates practically daily revisions whose circulation within the Bank remains relatively restricted. Consequently, a simpler system should be established through a bi-monthly publication of the status of arrears on loans.

6.13 The status of arrears on loans presents the situation of arrears as it was a fortnight previously. Management therefore has fifteen days to verify the confirmation of payment orders given by Borrowers before the official publication of the status of arrears.

6.14 Proposal 7: Management shall regularly publish on a bimonthly basis a status of arrears on loans, indicating the Borrowers and loans in arrears, and payment maturity thereof. As soon as a loan appears for the first time in the document, Management shall notify the Borrower and the Guarantor about the situation of arrears and sanctions applicable in case of default in payment.

### Application of Sanctions

6.15 The ADB Group's sanctions are not as harsh as those of other MDBs. The third sanction whose impact is most telling on the Borrower is only applied after 9 months. As for the first sanction, its application after three months has a very minimal dissuasive effect; it is not surprising, therefore, to see an accumulation of arrears of less than 3 months and an increasing number of borrowers with arrears of 3 to 6 months. Management proposes to make sanctions more strict in order to improve the recovery rate and limit the amount of arrears that reach the 9 month maturity period.

6.16 Proposal 8: Arrears of 30 or more days (sanction No.1)  
Fifteen (15) days after the due date, ADB Management shall notify the Borrower and the Guarantor of the risk of sanctions should the payment of the arrears not be made before a given date (30 days from the due date). If the arrears attain a maturity of 30 or more days, the Borrower shall be liable to suspension of signature of all new loan Agreements. ADB Management shall immediately inform the Borrower and the Guarantor of these measures. If, fifteen (15) days later there is still no payment, the suspension of signing of all new loan Agreements shall be extended to the Guarantor. ADB Management shall immediately inform the Guarantor accordingly.

6.17 Proposal 9: Arrears of 90 or more days (sanction no. 2)  
At the expiration of 60 days from the due date, Management shall inform the Borrower and the Guarantor of sanctions which they will suffer should the arrears not be settled 90 days from the due date. If, at this date, the arrears have not been settled, the Borrower and the Guarantor shall be liable to:

- a) suspension of the submission of new loans for the Boards of Directors' approval;
- b) suspension of further disbursement of the loan in arrears.

6.18 Proposal 10: Arrears of 120 or more days (sanction no.3)  
As soon as the arrears attain a maturity period of 120 days, Management shall inform the Borrower and the Guarantor of sanctions applicable if no settlement is made 180 days after the due date. If the arrears attain a maturity period of 180 days, the Borrower and the Guarantor shall be liable to:

- the suspension of all disbursement of loans granted by the ADB Group.

### Cross-Default

6.19 Proposal 11: The cross-default rule existing between the three ADB Group institutions shall only come into effect on the application of sanction no.3: total suspension of all disbursement of loans granted by one of the institutions.

### Suspension of Disbursements

6.20 Up to the end of 1988, Management did not authorize the receipt of applications reaching ADB headquarters or one of its regional offices after the sanction on the suspension of disbursements had come into effect. In a recent Board decision, however, Management was requested to consider, not the date of receipt of the application but the date that it was dispatched. In view of the postal constraints in Africa, the average effect of this measure is to give the Borrower about one month's advantage. However, this measure leads to:-

- a) an increase in administrative duties since the registering of a new reference date is no longer automatic. A new kind of monitoring is required.
- b) difficulty in defining the date of dispatch since that could be:
  - postal for applications sent by post;
  - the date in the Borrower's letter (unfortunately not all applications are accompanied with such a letter);
  - also the date on the disbursement application.

Added to this confusion is the possibility of irregularities arising from letters post-dated to avoid the suspension of disbursements.

6.21 Whatever the reference date maintained for the suspension of disbursements, this sanction without doubt puts enterprises in a difficult situation and creates tension between the various participants in the implementation of projects and programmes financed by the Bank Group. Management is of the view that a solution that would enable the acceleration of disbursements by reducing the period between the procurement of goods and services and payment should be found.

6.22 Proposal 12: In order to perfectly master the suspension system, Management proposes that the non-authorization of applications received after sanctions might have come into effect should be reinstated, subject to conditions subsequently enumerated and proposal no.13 hereunder.

6.23 Proposal 13: Management proposes that payment should be authorized for works carried out and services rendered as well as for supplies made or ordered before the date that the suspension of disbursements. However, applications for such payment shall reach the ADB within 60 days of the coming into effect of sanctions.

#### Lifting of Sanctions

6.24 Proposal 14: Sanctions shall be automatically lifted on the day following confirmation of the full payment of arrears.

#### Multinational Loans

6.25 Proposal 15: The exemption notwithstanding, arrears on multinational loans shall result in the application of sanctions to Borrowers and Guarantors.

#### Exemptions

6.26 The Board of Directors recently approved the exemption from sanctions of technical assistance services which include training fees and fellowships since their interruption would be unpleasant to individuals; TAF loans shall be exempt from the effect of sanctions.

6.27 Generally, the effect on people on fellowship or undergoing training financed by the ADB Group is essentially individual in nature. Management is therefore of the view that payment of all training fees and fellowships shall continue uninterrupted.

6.28 In regard to loans intended mainly for carrying out of pre-investment studies, institutional support, etc., and for which the procurement of goods and services from other enterprises is not stipulated as

a condition for implementating technical assistance activities and consultancies, Management is of the view that for loans financed from TAA/TAF resources, exemption shall be made on such expenses by adding thereto minor procurements of support equipment (vehicles, computers).

6.29 On the other hand, for technical assistance staff whose activities centre almost entirely on the implementation of works or the procurement of certain supplies, Management is of the view that in such cases proposal 12 hereabove concerning works and services implemented shall apply since technical assistance activities and those concerning other enterprises are in fact joint goods and services. The non-implementation of works by other enterprises logically follows the non-implementation of works by technical assistance services.

6.30 Proposal 16: Exemption from sanctions: Generally, sanctions shall not be applied in the case of:

- a) special commitments (repayment guaranties or others) entered into by the ADB Group. However, the ADB Group shall make no amendments whatever to the special commitments after the coming into effect of the sanction on the suspension of disbursements;
- b) technical assistance services and consultancy for pre-investment studies, institutional support financed with TAA/TAF, ADF or ADB non-refundable or conditionally refundable resources;
- c) multinational projects and programmes;
- d) training fees and fellowships;
- e) expenses refundable to the ADB Group from bilateral or other resources after the confirmation of disbursement or on application from the ADB Group;
- f) when a Borrower's arrears shall be equal to or less than BUA 25,000.

#### Cost Overruns

6.31 Generally, the ADB Group does not finance cost overruns resulting from the application of sanctions. However, the Board of Directors could in exceptional cases study and take into consideration Management's recommendations for the financing of cost overruns.

### 7. CONCLUSION AND RECOMMENDATIONS

7.1 The 1985 Directives enabled the ADB Group to stem the deterioration of its portfolio and to reduce the volume of arrears. However, these Directives are not enough to turn the situation around appreciably. Experience has revealed certain loopholes that should be filled through the updating of the policy and procedures on the recovery of arrears.

7.2 The new policy should safeguard the financial credibility of the ADB Group while at the same time maintaining a positive resource flows to borrowing countries. It should also reduce the negative effects borne by enterprises implementing projects and programmes financed by the ADB Group. Through more systematic information, it should help borrowers to better programme their repayments. Consequently, Management recommends that the Boards of Directors approve the new policy and procedures on the recovery of arrears attached hereto which contain the proposals made in this document.

However, Management is of the view that this policy will subsequently be followed with a report and proposals on countries in substantial arrears over a very long period (more than 12 months) - Liberia, the Comoros, Sierra Leone, Congo, Benin, etc. - with a view to helping resolve this problem by contributing to the introduction of debt-service management and better loans programming in these countries in order to reduce the financial and economic risks associated with certain interventions.

ANNEXPage.1Table 1Table 1.1Evolution of Arrears as at 31/12  
(in BUA million)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
ADB	32.41	37.08	57.81	73.35
ADF	1.41	1.64	1.90	2.82
NTF	2.51	2.01	2.94	3.25

Table 1.2Evolution of loans outstanding as at 31/12  
(Disbursed unrefunded loans)

(in BUA million)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
ADB	1.025	1.255	1.548	2.013
ADF	898	1.145	1.441	1.750
NTF	50	54	59	63

Table 1.3Arrears Rate as at 31/12  
(Arrears/Loans outstanding)

(in BUA million)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
ADB	3.2 %	3.0 %	3.7 %	3.6 %
ADF	0.16%	0.14%	0.13%	0.16%
NTF	5.0 %	3.7 %	5.0 %	5.2 %

Table 2

Distribution of arrears as at 31/12 according to payment maturities  
(in BUA million and percentage)

Table 2.1 : ADB

	<u>6 months</u>	<u>9 or more months</u>	<u>Total</u>
1985	19.60 (60 %)	13.00 (40 %)	32.60 (100 %)
1988	33.19 (45 %)	40.16 (55 %)	73.35 (100 %)

Table 2.2 : ADF

	<u>6 months</u>	<u>9 or more months</u>	<u>Total</u>
1985	0.98 (70 %)	0.43 (30 %)	1.41 (100 %)
1988	1.88 (67 %)	0.93 (33 %)	2.82 (100 %)

Table 2.3 : NIF

	<u>6 months</u>	<u>9 or more months</u>	<u>Total</u>
1985	1.15 (46 %)	1.36 (54 %)	2.51 (100 %)
1988	1.55 (48 %)	1.70 (52 %)	3.25 (100 %)



Table 3Table 3.1Debt recovery rate as at 31/12

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
ADB	79.7 %	82.8 %	77.7 %	79.0 %
ADF	85.2 %	84.7 %	86.5 %	84.7 %
NTF	56.5 %	76.1 %	66.9 %	70.0 %

Table 3.2 : ADB

(in BUA million)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Arrears at the beginning of the year	19.73	32.41	37.08	57.81
Figure for the year	140.19	183.73	222.44	293.56
Total due	159.92	216.14	259.52	351.37
Minus payment	127.51	179.06	201.71	277.84
Arrears end of year	32.41	37.08	57.81	73.35
Recovery Rate	<u>79.7 %</u>	<u>82.8 %</u>	<u>77.7 %</u>	<u>79.0 %</u>

Table 3.3 : ADF

(in BUA million)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Arrears at the beginning of year	1.56	1.41	1.64	1.90
Figures for the year	8.01	9.36	12.45	16.55
Total due	9.57	10.77	14.09	18.45
Minus payment	8.16	9.13	12.19	15.63
Arrears at the end of year	1.41	1.64	1.90	2.82
Recovery rate	85.2 %	84.7 %	86.5 %	84.7 %

Table 3.4 : NTF

(in BUA million)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>
Arrears at the end of year	1.16	2.51	2.01	2.94
Figures for the year	4.69	5.90	6.89	7.90
Total due	3.25	8.41	8.90	10.84
Minus payment	3.25	6.40	5.96	7.59
Arrears at the end of year	2.51	2.01	2.94	3.25
Recovery rate	56.5 %	76.1 %	66.9 %	70.0 %

Table 4Table 4.1Distribution of countries as at 31/12 according to payment maturities

	<u>6 months</u>	<u>9 or more months</u>
1985	27 countries + Multinationals	13 countries + Multinationals
1988	26 countries + Multinationals	9 countries + Multinationals

Table 4.2 : ADB

	<u>6 months</u>	<u>9 or more months</u>
1985	27 countries + Multinationals	9 countries + Multinationals
1988	23 countries + Multinationals	7 countries + Multinationals

Table 4.3 : ADF

	<u>6 months</u>	<u>9 or more months</u>
1985	16 countries + Multinationals	8 countries
1988	15 countries + Multinationals	3 countries

Table 4.4 : NTF

	<u>6 months</u>	<u>9 or more months</u>
1985	12 countries + Multinationals	7 countries + Multinationals
1988	10 countries + Multinationals	1 country + Multinationals

Table 4.5Concentration of the longest arrears (9 or more months)

	<u>ADB</u>	<u>ADF</u>	<u>NTF</u>
1985	6 countries (86 %)	widely spread	3 countries (82 %)
1988	4 countries (94 %)	3 countries (100%)	1 country (100 %)

Evolution of the number of countries under sanctions according  
to maturity date

<u>Number of sanction</u>	<u>ADB</u>			<u>ADF</u>			<u>NTF</u>		
	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>1st</u>	<u>2nd</u>	<u>3rd</u>	<u>1st</u>	<u>2nd</u>	<u>3rd</u>
1									
2									
2nd maturity 1986	31	18	14			13	12	8	7
1st maturity 1987	26	18	7	22	11	6	13	4	3
2nd maturity 1987	31	20	10	25	14	8	13	7	2
1st maturity 1988	30	19	10	29	11	9	15	8	1
2nd maturity 1988	29	23		26	16		14	10	

AFRICAN DEVELOPMENT BANK  
ADB/BD/WP/89/66/Add.1

AFRICAN DEVELOPMENT FUND  
ADF/BD/WP/89/54/Add.1

8 June 1989

Original: FRENCH

Translated by: ALEG

MEMORANDUM

TO : BOARDS OF DIRECTORS

FROM : A. B. BEYE  
Secretary General

*AB*

SUBJECT : POLICY RELATING TO THE RECOVERY OF ARREARS ON LOANS

Please find enclosed herewith the draft on the Policy relating to the recovery of arrears on Loans granted by ADB/ADF.

The President's memorandum (Document ADB/BD/WP/89/66 - ADF/BD/WP/89/54 of 25 May 1989) relating to the above subject has already been distributed to members of the Boards of Directors.

Enc.

**AFRICAN DEVELOPMENT BANK**

**AFRICAN DEVELOPMENT FUND**

**POLICY RELATING TO THE RECOVERY OF  
ARREARS ON LOANS**

**POLICY RELATING TO THE RECOVERY OF  
ARREARS ON LOANS**

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**I. PURPOSE**

1.1 The Policy relating to the recovery of arrears on loans, prescribes the rules, particularly the sanctions applicable to Borrowers and/or Guarantors in default of payment of maturities in respect of the principal and financial charges on loans granted by the African Development Bank (ADB) and the African Development Fund (ADF)\*.

1.2 The Policy relating to the recovery of arrears on loans is adopted and shall be executed without prejudice to the provisions of the ADB/ADF General conditions applicable to Loan Agreements and Guarantee Agreements dated respectively 8 April 1974 and 22 March 1974.

**II. SANCTIONS**

Any Borrower who obtains a loan or loans from ADB/ADF and any Guarantor as the case may be, shall be liable to sanctions for arrears accumulated by the Borrower.

**2.1 TYPES OF SANCTIONS**

(a) Prohibition of the Borrower and/or the Guarantor from signing any new loan Agreement and/or guarantee agreement.

(b) i Suspension of disbursements in respect of a loan or loans on which the Borrower has accumulated arrears.

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\* The Policy on the recovery of arrears on loans shall be applicable to ADB (or NTF) and ADF Loans.

- ii Suspension of granting any new loans to the Borrower and/or Guarantor;*
- (c) i Suspension of disbursements in respect of all loans granted to the Borrower and/or Guarantor*
- ii Application of the cross-effective sanction clause (prescribed in Section 6.02 of the General Conditions) to the Borrower and to the Guarantor as the case may be.*

## *2.2 MODALITIES FOR THE APPLICATION OF SANCTIONS*

*2.2.1 Sanctions prescribed by the present policy shall be applied in a progressive manner.*

- a) i The prohibition of the defaulting Borrower from signing any new loan or guarantee agreements shall be applied automatically after the thirtieth day, from the date of default of payment of maturities.*
  - ii The prohibition from signing any new Loan or Guarantee Agreement shall be applied automatically to the Guarantor, fifteen (15) days after the date of application to the Borrower of the sanction referred to above.*
- b) i The suspension of disbursement in respect of loan(s) granted to the Borrower on which there are arrears, as well as the suspension of the granting to the Borrower any new loans, shall apply automatically in a cumulative manner after the ninetieth day from the date of application of default of payment of maturities.*
  - ii The suspension of granting to the Guarantor any new loan shall be applied automatically fifteen (15) days after the date of the application of the sanction on the concerned Borrower.*



- (c) i *The suspension of disbursements in respect of all loans granted to the Borrower as well as the application of the cross-effective sanction clause shall be applied automatically in a cumulative manner, one hundred and eightieth day (180) from the date of default of payment of maturities.*
  
- ii *The suspension of disbursements in respect of all loans granted to the Guarantor, as well as the application of the cross-effective sanction clause of the Guarantor shall be applied in a cumulative manner automatically, fifteen (15) days from the date of application of the sanction to the Borrower referred to above.*
  
- iii *The cross-effective sanction clause shall be automatically applied to the Borrower and the Guarantor as the case may be, in respect of suspension by the ADF or the ADB for disbursements relating to all loans granted to the Borrower and/or to Guarantor.*
  
- (iv) *The application of the cross-effective sanction clause by ADB/ADF shall have the unique effect, the suspension by the ADF or the ADB as the case may be, of disbursements in respect of all loans granted to the Borrower and/or the Guarantor.*

*The cross-effective sanction clause does not therefore have any implications on other sanctions prescribed under the present policy.*

*2.2.2 Every Borrower or Guarantor member State whose loans are in arrears, shall bear the prescribed sanctions alone without extension to any other Borrower guaranteed or not, by this member State and located in its territory who honour its commitments at maturity to ADB/ADF.*

2.2.3 In the case of arrears on a multinational project or program, ADB/ADF shall continue the relevant disbursements, but the member States having a legal lien with ADB/ADF in respect of the project, shall be liable as a unique sanction, to prohibition from signing any new loan, and/or Guarantee Agreement.

### 2.3 EXEMPTIONS FROM SANCTIONS

Notwithstanding the above provisions, the sanctions relating to arrears shall not be applicable in the following cases:

- a) technical assistance services financed from the resources of the ADF, allocated to the Technical Assistant Fund (TAF) especially for pre-investment studies, institutional strengthening...;
- b) training fees and fellowships.
- c) multinational projects and programs as stipulated in paragraph 2.2.3 above.
- d) work carried out and services rendered and supplies made or delivered before the application of sanctions on the suspension of disbursements. However, the application for relevant disbursement should reach ADB/ADF within sixty (60) days maximum after the date of the application of the sanctions concerned.
- e) expenses reimbursable to ADB/ADF from bilateral resources.
- f) arrears whose total amount is less or equal to BUA 25.000 or FUA 25,000 as the case may be.

2.4 The sanctions imposed on the Borrower and/or the Guarantor, on the reservation of the exemptions stipulated in paragraph 2.3 above, shall remain in force until all arrears have been settled.

- 2.5 Generally, ADB/ADF shall not participate in the financing of cost overruns in respect of projects and programs which would result from the application of sanctions on arrears.

Without prejudice to the preceding rule, the Boards of Directors could in exceptional case, study and take into consideration recommendations that Management will deem necessary to make for the financing of cost overruns so as to guarantee in the best way the efficiency of ADB/ADF operations.

- 2.6 Every Borrower and/or Guarantor liable to sanction shall be informed thereof by ADB/ADF in a reliable and appropriate manner, after having previously received in an opportune time, notification of the state of arrears which have resulted in the said sanctions.

- 2.7 Co-financiers of ADB/ADF, as well as suppliers of goods and services relating to ADB/ADF financed projects and programs, shall be duly informed of any suspension of disbursements applied to a Borrower and/or Guarantor who has defaulted in its loan repayments.

### III PERIODIC BRIEFING OF THE BOARDS

Management shall submit to the Boards a quarterly report on the position of arrears and the application of sanctions.

### IV. DATE OF ENTRY INTO FORCE

- 4.1 The present policy supercedes the Directives relating to recovery of arrears on ADB/ADF loans dated 14 February 1985, and all other contrary preceding provisions and shall enter into force with effect from the date of their adoption by the Boards of Directors.

- 4.2 However, and as a transitional measure, all past sanctions imposed on Borrowers and/or Guarantors will be maintained until the full recovery of the arrears that were responsible for the application of the sanctions.